INVESTMENT MANAGEMENT

Market Musings 6/25

For Professional Investors only

Playing Defence with Dividends

Today's equity markets are characterised by bouts of volatility, spurred by geopolitical tensions and macroeconomic uncertainties, mainly due to the start-stop nature of the US-initiated global trade war. This has investors seeking strategies that offer not only returns but also a certain degree of defensiveness. As a result, dividend investing, traditionally selected for its delivery of steady income, has re-entered the spotlight.

Positive long-run performance

An underappreciated characteristic of dividend investing, especially after the dominance of the technology sector of the past decade, is that historical performance data shows that dividend-focused portfolios have outperformed the broader market over the long run as above-average dividend yielders show better returns. Litzenberger and Ramaswamy (1979) were among the first to document the robust performance of high-yielding stocks. Jeremy Siegel's work, The Future for Investors (2005), further demonstrated that the highest-yielding stocks in the U.S. market outperformed the broader market by a clear margin from 1958 to 2003. More recently, Morningstar's 2022 study confirmed that high-yield portfolios have consistently outperformed non-paying and low yielding portfolios across regions.

Besides generating strong long term return, dividend strategies are typically more defensive. One of the reasons behind this phenomenon, we think, is that higher dividend-paying companies tend to be mature, cash-generative businesses. Investment needs are typically lower for mature businesses compared to higher-growth companies. This in turn leaves more room to distribute cash to shareholders, especially when balance sheets are strong. On top of that, high current free cash flow yields provide a margin of safety within valuations. These defensive characteristics make such companies particularly attractive in uncertain markets.

Our own experience with the Kempen Global Dividend strategy illustrates this point well. Over the past 25 years, the strategy has delivered positive returns in 17 out of 25 years. In the eight down years, the average decline was just 6%, compared to a 15% drop for the broader MSCI World Index. This pattern of lower losses during downturns while participating meaningfully during upturns is a key factor in the success of dividend investing.

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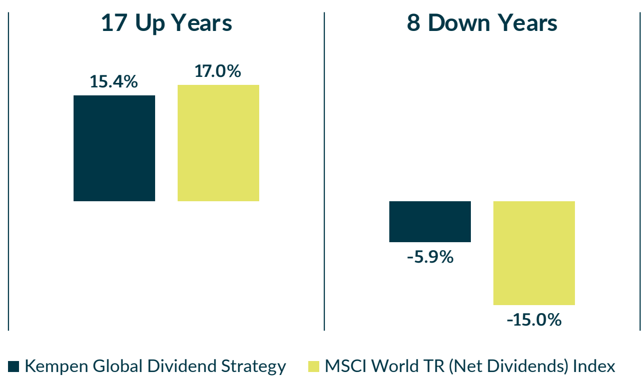
Insulation in falling markets

Figure 1 – The average yearly return in up- and down markets of the MSCI World



*Source: Van Lanschot Kempen. Performance figures based on representative account before fees for the period May 2000 until 31 December 2024. *The value of your investment may fluctuate; past performance is no guarantee of future results and your capital is at risk. The track record of the strategy is based on the consecutive gross returns (before deduction of fees and operational costs) of representative accounts, all managed to the same investment strategy and by the same team; first at ING and as of March 2006 at Kempen. They are the ING Hoog Dividend Aandelen Fonds and the Postbank Hoog Dividend Aandelen Fonds (31-5-2000 till 28-2-2006) , the Friesland Bank Aandelen Fonds (until 31-12-2007) and the Kempen Global High Dividend strategy since then.*

The importance of selectivity

Importantly, not all dividend payers are created equal. Chasing high dividend yield without regard for quality can lead investors into so-called "dividend traps". These are companies that offer high payouts but lack the financial strength to sustain them. On the flipside, lowering the bar on dividend yield and shifting to high dividend growth expectations, may lead to selecting unattractively valued companies with lower expected returns going forward as high growth expectations carry a higher risk of disappointment.

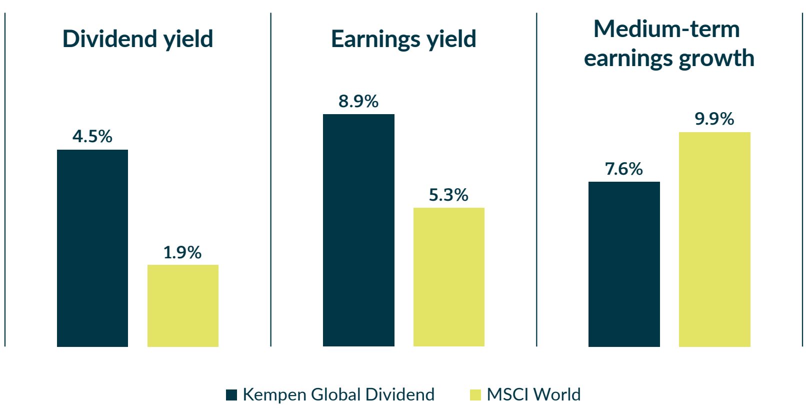
As we have written about in our previous **Market Musing**, we have observed a trend across dividend funds. In recent years, many asset managers have increased exposure to mega-caps with steep valuations which has negatively affected their dividend yields. On average, global dividend strategies have also increasingly resembled the MSCI World in terms of style tilt, thereby reducing the diversification benefits of investing in dividend equities.

By following a consistent investment philosophy, we increasingly differ from the dividend category. We focus on companies with robust cash flows, prudent capital allocation and a margin of safety through attractive valuations. In doing so, we seek a balance between dividend yield and expected growth by selecting companies with healthy fundamentals.

As of March 2025, the dividend yield of our portfolio stands at 4.5%, compared to 1.9% for the MSCI World. Meanwhile, our holdings exhibit a medium-term earnings growth estimate of 7.6%, versus 9.9% for the broader index. This combination of a higher yield, balanced with still attractive growth has proven to result in a defensive strategy with an attractive total return expectation.

Solid growth of dividend and earnings yield

Figure 2 – Weighted average dividend yield



Source: Factset, weighted average dividend yield, harmonic average earnings yield and est. 3-5yrs EPS growth. March 2025. Past performance is no guarantee of future returns.

A time-tested strategy for the long run

Recent market developments have once again validated our approach. In 2022 and again in 2025 (up until the end of April) our dividend strategy demonstrated its defensive qualities. In both cases, our strategy significantly outperformed the broader market, proving its defensiveness.

While the past decade was dominated by globalisation, low interest rates and the (U.S.) tech sector, the markets seemingly have undergone a regime shift. Inflationary pressures, rising rates, and heightened uncertainty due to increased trade friction and geopolitical instability are all contributing to volatile markets. By focusing on companies with strong and growing cashflows, disciplined capital allocation, and attractive valuations, we aim to deliver consistent returns while protecting against downside risk. This should help us navigate through these uncertain times.

Over the years, the Kempen Global Dividend strategy has shown a combination of reduced downside risk with solid upside participation and direct income. This makes it a compelling option for investors seeking resilience alongside long-term returns.

Market Musings authors

Reineke Davidsz
Portfolio Manager – Divdend Team

Follow Reineke on LinkedIn

Najib Nakad
Portfolio Manager – Divdend Team

Follow Najib on LinkedIn

VAN LANSCHOT KEMPEN

Beethovenstraat 300
1088 WZ Amsterdam
The Netherlands

vanlanschotkempen.com/investment-management

Follow us on LinkedIn