ProShares®

DIVIDEND INVESTING WHEN INTEREST RATES RISE

Dividend growers: A solution with all-weather potential

Dividend paying stocks and interest rate risk

The prospect of rising interest rates has been the most widely discussed topic in fixed income markets over the past few years. And rightly so, after a 30+ year bull market in bonds fueled by falling rates. Many investors are wrestling with positioning their fixed income allocations as the prospect of rising rates appears to draw closer.

While interest rates are often front and center for fixed income investors, equity investors also need to be mindful of the impact rates can have on their portfolios. This is especially important because many investors have turned to dividend paying stocks for income since interest rates have been so low.

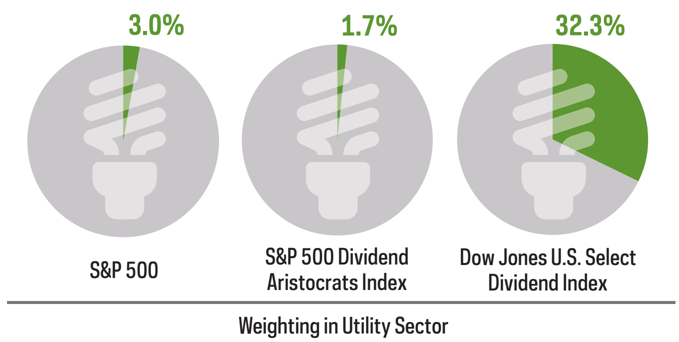
But not all dividend strategies are created equal. Investors should remember that the income from high yield strategies is often sourced from stocks in sectors that tend to be highly sensitive to interest rate movements, thus introducing interest rate risk into the equity allocation. Stocks that grow their dividends (but don't always have the highest yields) may potentially provide an all-weather dividend solution that can perform well regardless of the direction of rates.

Dividend growth vs. high dividend yield strategies

Generally speaking, dividend strategies can be classified as either seeking a high level of dividend income (high dividend yielders), or as seeking total return by targeting stocks that have grown their dividend over some time period (dividend growers). While these differences may seem subtle, they can represent meaningful differences in terms of their underlying holdings, as measured by their sector and performance patterns over time. Let's examine two popular dividend indexes as an example: Dow Jones U.S. Select Dividend™ Index vs. S&P 500® Dividend Aristocrats® Index.

A high dividend yield index like the Dow Jones U.S. Select Dividend Index has a yield advantage relative to a dividend growth index like S&P 500 Dividend Aristocrats. A key reason is a very large (30%+) weighting in utility stocks, which typically have had a high dividend payout ratio.

High Dividend Yield Strategy Had Large Overweight in Utilities
April 30, 2015



Source: S&P Dow Jones Indices. Dow Jones U.S. Select Dividend Index represents the United States' leading stocks by dividend yield. S&P 500 Dividend Aristocrats measures the performance of S&P 500 companies that have increased dividends every year for the last 25 consecutive years. The Dow Jones U.S. Select Dividend Index is shown here because it is the index tracked by the largest high dividend yield ETF by assets.

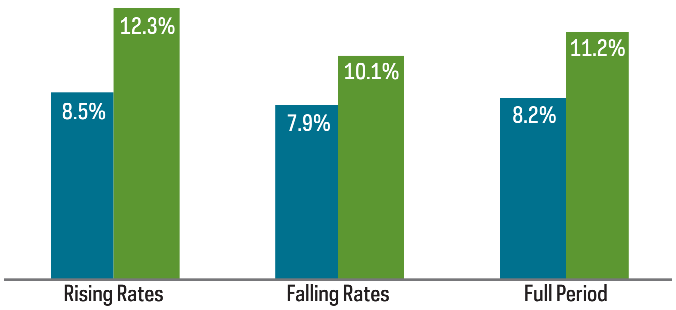
Note that the utilities weighting of the high dividend yield index represents not only a significant difference compared with a dividend growth index like the S&P 500 Dividend Aristocrats, but also compared with the S&P 500®, which has a utilities weighting of just 3.0%. This is an important distinction because as investors saw in 2013, the utilities sector has often underperformed during periods of rising interest rates.

Performance in various interest rate environments

For further insight into how sector differences can impact performance over time, we examined performance differences between the two dividend strategies in different interest rate environments.

Dividend Growers Outperformed High Dividend Yielders Regardless of Rate Direction
May 2005-April 2015

- Dow Jones U.S. Select Dividend Index (High Dividend Yielders)
- S&P 500 Dividend Aristocrats Index (Dividend Growers)



Source: Bloomberg. Results show average performance of dividend strategies based on monthly interest rate changes. **Past performance is not a guarantee of future results.**

Not only did the S&P 500 Dividend Aristocrats Index outperform the Dow Jones U.S. Select Dividend Index during the full period (May 2005-April 30, 2015), it also outperformed meaningfully during the period that interest rates increased. A specific example of this performance was the most recent extended spike in rates, which occurred during the "taper tantrum" between May 1 and August 20, 2013. During this period, rates on the 10-year Treasury rose from 1.63% to 2.81%, and the dividend growth index outperformed the high dividend yield index by approximately 200 basis points (bps).

Given the historical negative correlation of utility stocks to rates, one might expect a portfolio with a large concentration in utilities to have outperformed during a falling interest rate period like 2014. Despite widespread expectations for a rate increase in 2014, the 10-year Treasury decreased more than 85 bps during the period. And the high yielding index actually underperformed the dividend growth index. These results clearly show that a dividend growth strategy performed comparatively well in a variety of interest rate environments.

The takeaway

Dividend investing has become an important source of potential income for investors. But not all dividend strategies produce the same results.

- High dividend yield strategies have a yield advantage, but tend to underperform when interest rates rise.
- A dividend growth strategy, while yielding less, potentially offers an all-weather or evergreen equity solution—one that has historically outperformed regardless of the direction of interest rates.

ProShares Dividend Growers ETFs:

NOBL **ProShares S&P 500 Dividend Aristocrats ETF**

REGL **ProShares S&P MidCap 400 Dividend Aristocrats ETF**

SMDV **ProShares Russell 2000 Dividend Growers ETF**

EFAD **ProShares MSCI EAFE Dividend Growers ETF**

- Curated from popular indexes
- Stocks with the longest track records of consecutive dividend growth

Find out more

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This information is not meant to be investment advice.

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