Worried About a Bear Market? Here's How You'd Have Fared if You'd Bought Canada's Top Dividend Growers During 2008

Description

With a resolution for the COVID crisis nowhere in sight, investor hesitancy is seemingly warranted, as a sustainable economic recovery might not materialized until well into 2021. However, one thing is for certain, even in the face of this bleak outlook: a diversified portfolio of stocks and bonds has always proven to be the best source of investment returns over a long-term horizon.

To put this theory to the test, I put together a portfolio consisting of the best dividend growers in Canada. The reason I chose the dividend growers over simply dividend *payers* is because the former companies tend to exhibit better balance sheets and financial discipline over the latter.

For example, in a study done by Ned Davis Research, dividend growers and initiators on the S&P500 returned an annualized 12.9% with a standard deviation of 15.6% between 1972 to 2019, while companies who kept their dividends the same or cut their payouts exhibited returns of 11.9% and 10.9% at standard deviations of 18% and 24%, respectively (a lower standard deviation implies lower volatility).

A similar study conducted by RBC Global Asset Management pointed to the same outcome: dividend growers returned 11% annualized from 1986 to 2019 compared to 9.2% for the payers and just 1.6% for the cutters. Moreover, dividends have proven to be a significant contributor of overall equity returns, with dividend reinvested returns on the TSX almost four times greater than dividend-excluded returns from 1976 to 2019.

Given the importance of dividends — particularly companies that focus on sustainably growing said dividends — I created a classic 60/40 portfolio with the 60% equity component consisting of the top six Canadian dividend names.

To keep things simple, six equity holdings were divided equally (10% each). The companies selected were all household names: **Canadian National Railway**, **Fortis**, **Enbridge**, **Royal Bank**, **Saputo**, and **BCE**.

All six of the chosen companies have exhibited strong balance sheet discipline and dividend growth; for example, BCE has increased its dividend by 128% since Q4 of 2008, while keeping its payout ratio within a manageable 65-75% of free cash flows.

The remaining 40% of the portfolio was evenly split between plain-vanilla passive Canadian and U.S. passive bond funds. The test period spanned from January 2, 2008 until April 30, 2020, which would mean our hypothetical portfolio captured the worst of the 2008 recession, the 2016 and 2018 selloffs, and, of course, the recent bear market plunge.

The results: despite the unlucky timing, it seems patience has paid off once again. The hypothetical portfolio returned an annualized 10.4% at a standard deviation of 7%, crushing passive-index funds, which track the TSX and the currency hedged S&P 500 (4% and 7% annualized at 14% and 16% standard deviation, respectively, across the test period).

Finally, to ensure that the outperformance was due to security selection, I compared the dividend portfolio to one in which the equity component consisted of just a single passive ETF tracking the TSX, while keeping the bond allocation the same. Sure enough, this passive 60/40 portfolio returned only 6% across the test period, with a similar level of volatility, also underperforming the dividend portfolio.

In conclusion, it pays to buy dividend *growers,* as these names, by nature, are some of the most well-run companies in Canada. Even in our simple experiment consisting of just six stock holdings and two bond funds, we managed to outperform the indices thanks to superior security selection.

So, even if you are hesitant about investing here, bear in mind that a portfolio consisting of the best dividend growers in Canada exhibit strong durability in the face of prolonged market downturns and will reward you for your patience.

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