

# Dividend Growth: A Catalyst for Long-Term Capital Appreciation

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## Summary

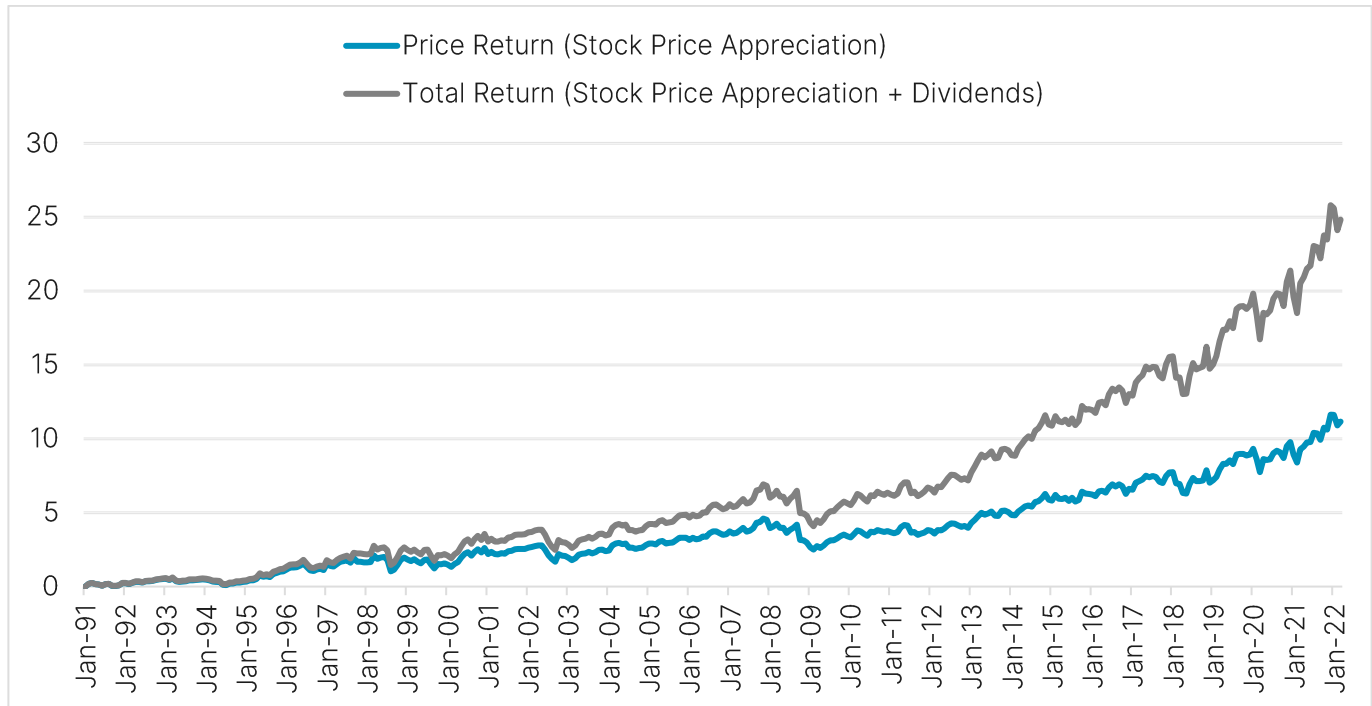
- Equity investment in dividend-growing securities offers an avenue to potential long-term outperformance, but entails an added risk of securities curtailing their dividend payment programs when facing periods of economic duress
- One method of reducing the risks associated with investing in companies that have committed to year-on-year dividend growth strategies is to identify underlying fundamentals associated with successful dividend growth in the recent past and target securities that currently exhibit such qualities
- The Nasdaq Victory Dividend Accelerator Index™ (NQVDIV™) offers a transparent, rules-based approach that aims to identify the underlying fundamentals that allow for the capturing of alpha-generating, long-term exposure through a portfolio of disciplined, resilient dividend-growing securities
- The VictoryShares Dividend Accelerator ETF (VSDA) tracks the Nasdaq Victory Dividend Accelerator Index (NQVDIV)

## The Power and Peril of Dividend Investing

Identifying the long-term value of a security is at the heart of all equity portfolio construction, but the method employed varies greatly. While stock valuation models are as diverse as they are numerous, there is no denying the beneficial impact of capital returned to shareholders via dividends. In comparing the long-run returns of equities, the capacity for consistent dividend-paying companies to outperform their larger peer group is made clear. Such comparisons require an analysis beyond the movement in stock price to include a holistic view of return on investment. By incorporating returns of capital via dividends into the broader investment decision paradigm, investors can unlock the alpha-generating power of securities that adhere to a regimen of consistently growing dividends.

To illustrate the importance of dividends for long-term investors, the chart below compares the 30-year returns of PepsiCo, Inc. (NASDAQ: PEP), with and without including the impact of dividends on returns. Throughout this period, PepsiCo, Inc. unfailingly paid a quarterly dividend while increasing the amount paid every calendar year. The result is a tremendous stock price return made extraordinary with the inclusion of dividends.

## Dividend &amp; Stock Price Analysis: PepsiCo, Inc.



As exceptional as those dividend-driven returns may be, paying dividends requires a company to direct capital away from day-to-day operations. For many companies, this paying of dividends does not adversely affect their ability to undertake vital activities such as servicing debt, procuring goods and services, and paying employees. However, all companies are susceptible to cutting or canceling their dividend program when facing significant financial duress. Financial duress can be specific to a company or sector, such as the fallout from the oil supply glut in 2014-2016, or reflective of a wider economic downturn, such as the nadir of the financial crisis in 2008-2009.<sup>1,2</sup> The pandemic in 2020 caused severe economic turmoil and uncertainty, resulting in stress on industries across countries consequentially triggering global dividend cuts.<sup>3</sup> When companies cut or cancel their dividend program, the result is a significant loss in short-term and long-term shareholder value. The immediate fallout is typically a sharp decline in price. Many companies subsequently take years to stabilize their dividend payment strategies, if indeed they ever do.

## A Fundamental Approach to Dividend Growth

In order to capture the alpha-generating impact of dividends while avoiding the pitfalls of dividend cuts and cancellations, dividend-oriented portfolio construction must take into account a wide array of factors to ensure the securities selected exhibit a past commitment and present financial capacity to consistently grow their dividend payments. The Nasdaq Victory Dividend Accelerator Index (NQVDIV) seeks to create a diversified portfolio of securities that are forecasted to grow dividends based on a combination of historical dividend growth and various financial metrics.

The Index applies 15 factors with a 10-year lookback to all Nasdaq US Large Mid Cap Index™ (NQUSBLM™) securities that paid a dividend during the evaluation period.<sup>4</sup>

<sup>1</sup> <https://finance.yahoo.com/news/4-major-oil-producers-cut-190507857.html>

<sup>2</sup> <http://www.bankrate.com/investing/what-to-do-when-companies-cut-dividends/>

<sup>3</sup> <https://www.cnbc.com/2021/02/22/220-billion-of-global-dividends-cuts-in-2020-janus-henderson-says.html>

<sup>4</sup> The universe excludes REITs and BDCs

Dividend Yield	Net Income Stability (10-year)
Return on Equity (ROE)	Sales Stability (5-year)
Return on Invested Capital (ROIC)	ROE Trend (5-year)
Pre-Tax Income to Debt	Cash to Market Value
Dividend Consistency (5-year)	Price Volatility
Trailing E/P	Size
Gross Margin	Years of Continuous Dividend Growth
Net Income Stability (5-year)	

These factors serve as the independent variables in a logit regression model that scores and ranks the input components. Having evaluated the historical impact of these factors on dividend growth, the Index assigns scores to the current universe of securities based on their underlying factor data. The result is a portfolio of 75 US securities that are willing and able to drive value to investors through consistent year-on-year dividend growth.

The table below shows the “Hit Rate” at which NQVDIV components grew their trailing twelve-month dividend payments year-on-year. The NQVDIV index maintained an elite level of dividend growth for more than 15 years, including two extraordinary market downturns in the fallout from the Tech Bubble and the Financial Crisis. In comparison to other indexes the dividend growth hit-rate for NQVDIV in 2020 and 2021 was higher during the pandemic period. Ultimately, the NQVDIV methodology proved consistent and resilient in its capacity to identify dividend-growing securities.

#### Dividend Hit Rate: 2001 – 2021

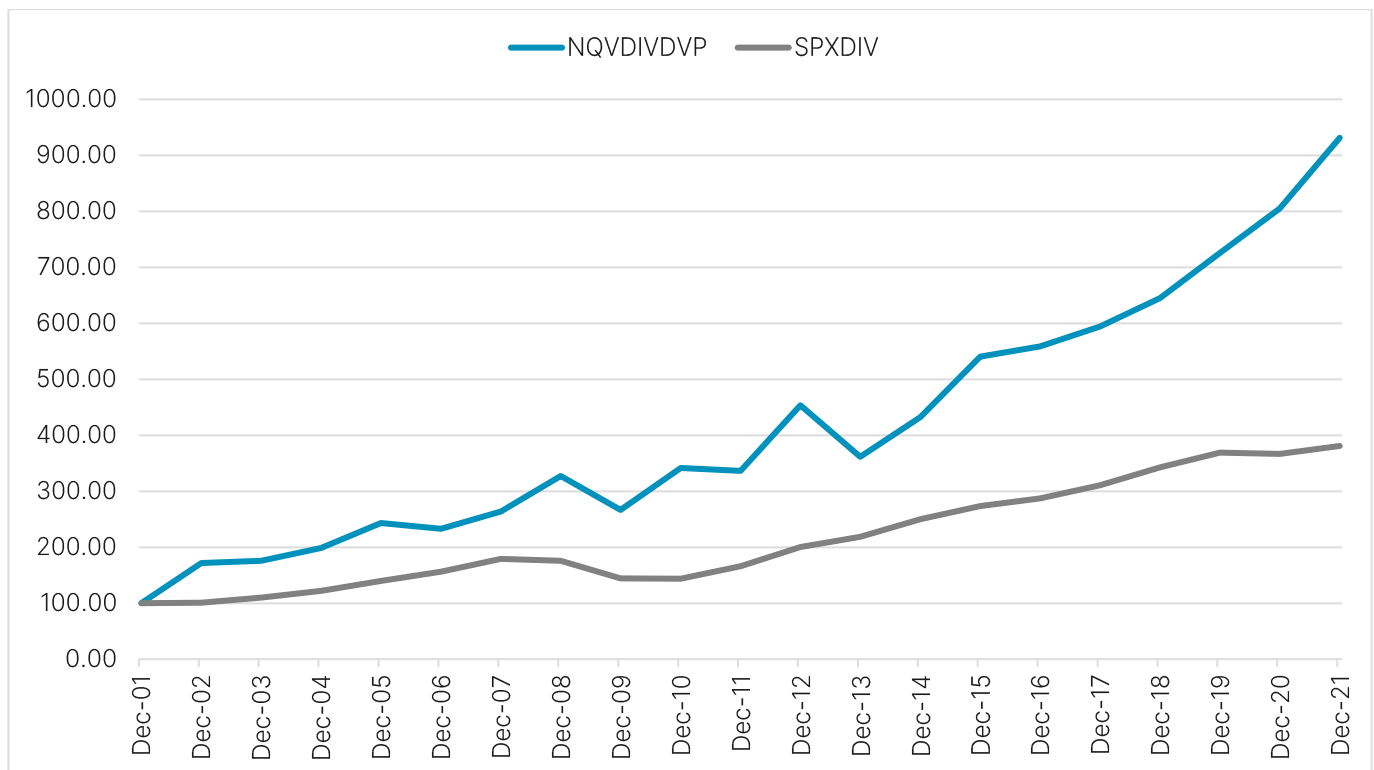
Year	NQVDIV	WTDGI	DGRO	RDIV	VIG
2001	95.9%				
2002	92.0%				
2003	97.3%				
2004	100.0%				
2005	100.0%				
2006	97.2%				
2007	100.0%				
2008	98.7%				
2009	95.9%				
2010	94.7%				
2011	97.3%				
2012	98.7%				
2013	97.3%	82.1%		56.7%	99.2%
2014	100.0%	86.4%	97.0%	55.0%	99.3%
2015	100.0%	84.4%	96.2%	63.8%	98.9%
2016	100.0%	81.1%	92.2%	51.7%	94.2%

Year	NQVDIV	WTDGI	DGRO	RDIV	VIG
2017	100.0%	87.7%	95.2%	70.0%	96.7%
2018	100.0%	82.7%	93.2%	75.4%	95.6%
2019	98.7%	86.3%	92.7%	63.9%	95.6%
2020	89.2%	73.5%	78.2%	33.3%	84.9%
2021	95.9%	87.0%	90.8%	61.7%	94.3%

NQVDIV Nasdaq Victory Dividend Accelerator Index  
 WTDGI WisdomTree U.S. Quality Dividend Growth Index  
 DGRO iShares Core Dividend Growth ETF  
 RDIV Oppenheimer Ultra Dividend Revenue ETF  
 VIG Vanguard Dividend Appreciation ETF

To illustrate how this successful hit rate affects the investor experience, the chart below tracks the cumulative growth in the Index Dividend Point values associated with the NQVDIV Index. The Index Dividend Point values are a means of mathematically normalizing the impact of dividends paid out by index components. Given differences in share price across index components, the absolute value of dividends paid by each company on a per share basis does not accurately reflect the realized dividend-driven returns. The Index Dividend Point value weights the magnitude of dividends paid out in a manner that is reflective of each index component’s position within the index. Relative to the S&P 500 Index, the NQVDIV Index has realized a higher level of IDP growth year-to-year and on a cumulative basis, thus delivering a superior level of dividend-driven return.

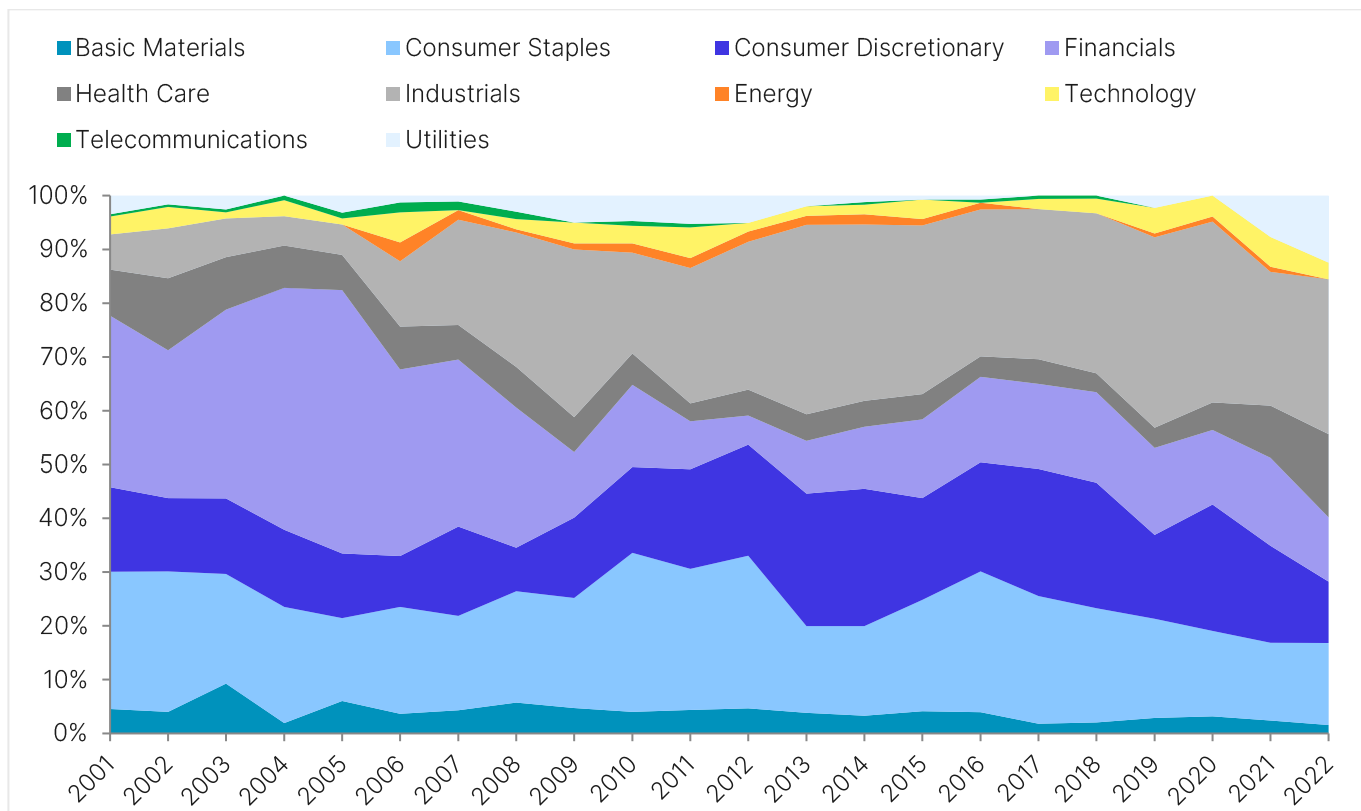
Year-on-Year Growth in Cumulative IDP Value – NQVDIV VS SPX



## Tactical allocation within Dividend Growth

In addition to the superior dividend-driven returns, the focus on underlying fundamentals in the component selection process generates a far more dynamic allocation than is typical of dividend-growth indexes. Many dividend-growth indexes utilize an inductive process of blindly selecting all securities that have grown their dividend payments, which neglects the industry-specific challenges facing companies. The NQVDIV Index, through an in-depth multi-factor analysis, deduces which companies are in the best financial position to grow their dividend payments without imperiling their business. As evidenced by the chart below, the Index offers a tactical sector allocation that reflects the ever-changing outlook facing a given industry.

### ICB Industry\* Composition Overview: March 2001 – March 2022



\*Prior to 2020, Consumer Staples history shown was Consumer Goods, Consumer Discretionary was Consumer Services and Energy was Oil & Gas.

A final differentiating element of the NQVDIV Index is its nuanced weighting scheme. The 75 index components are derived from three buckets:

- Bucket 1: the top 50 scoring securities with 20+ years of dividend growth
- Bucket 2: the top 15 scoring securities with 10-19 years of dividend growth
- Bucket 3: the top 10 scoring securities with 5-9 years of dividend growth

The index aims to create a broader approach to identifying value in dividend growth by avoiding a bias towards securities that have grown their dividends for multiple decades. In general, as publicly traded companies mature, they place a greater emphasis on return of capital to shareholders. Simply put, older companies face greater

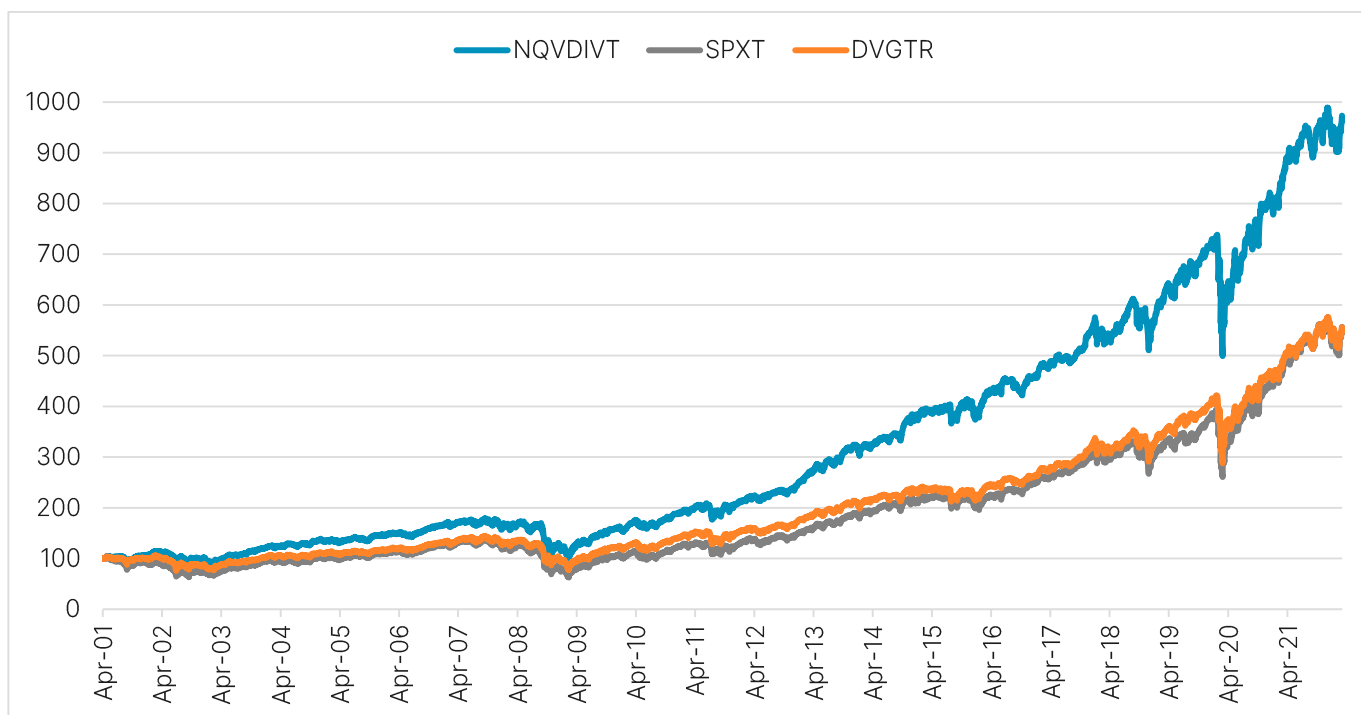
challenges finding viable investment opportunities. With one third of its components having grown their dividends for less than 20 years, the NQVDIV Index provides exposure to companies all across the business maturation spectrum. Moreover, the Index employs a tiered weighting scheme in order to optimize these differences. All securities are weighted by a combination of dividend yield and 10-year net income stability. These two factors are combined to derive a weight for each security in a manner specific to the bucket that the security falls into:

- Bucket 1: 75% dividend yield and 25% 10-year net income stability
- Bucket 2: 50% dividend yield and 50% 10-year net income stability
- Bucket 3: 25% dividend yield and 75% 10-year net income stability

For securities that have been growing their dividend for multiple decades, the Index takes advantage of their long history of prudent dividend policy by maximizing exposure to dividend yield. In evaluating securities with more abbreviated dividend growth track records, the Index emphasizes greater stability in profit growth and the price appreciation that typically coincides. This highly targeted weighting scheme is emblematic of the NQVDIV Index's capacity to identify value that can be neglected when one fails to look beyond the number of years of continuous dividend growth.

The result of NQVDIV's multi-layered, dynamic approach to generating robust long-term dividend growth has demonstrated a sustained and compounding level of outperformance versus the wider market and dividend-focused indexes alike.

#### Index Total Return Performance: 4/27/2001 – 3/31/2022

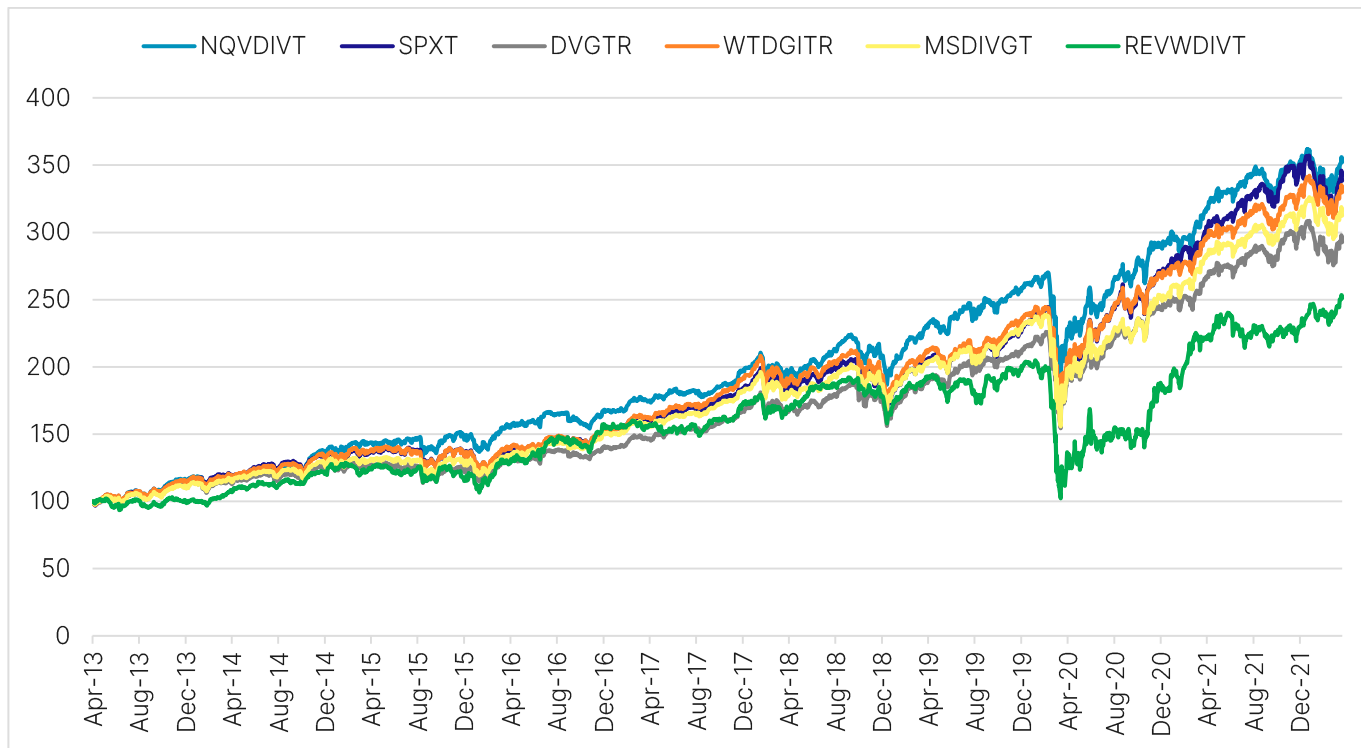


**NQVDIVT** Nasdaq Victory Dividend Accelerator Total Return Index

**SPXT** S&P 500 Index Total Return

**DVGTR** Nasdaq Dividend Achievers Select Index

Index Total Return Performance from WTDGI Launch: 4/11/2013 – 3/31/2022



- NQVDIVT Nasdaq Victory Dividend Accelerator Total Return Index
- SPXT S&P 500 Index Total Return
- DVGTR Nasdaq Dividend Achievers Select Index
- WTDGITR WisdomTree U.S. Quality Dividend Growth Total Return Index
- MSDIVGT Morningstar U.S. Dividend Growth Total Return Index
- REVWDIVT S&P 900 Dividend Revenue-Weighted Total Return Index

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