Brompton Insights

A Prime Time for Dividend Stocks

BROMPTON FUNDS

September 10, 2024

Fund in focus: Dividend Growth Split Corp.

In recent years, dividend-paying stocks in Canada have faced challenges due to rising short-term interest rates which provided yield-seeking investors with alternative income-generating options. Unlike the United States, Canada lacks a robust high-yield corporate bond and municipal bond market, leaving investors with limited alternatives outside of stocks, Canadian government bonds and Guaranteed Investment Certificates (GICs). As interest rates sharply increased over the last two years, yield seeking investors rotated away from dividend equities to safer and higher yielding fixed income products. However, as rates continue to fall and cash yields eventually drop, we expect to see a reversal in this trend as tax-advantaged dividend income becomes relatively more attractive.

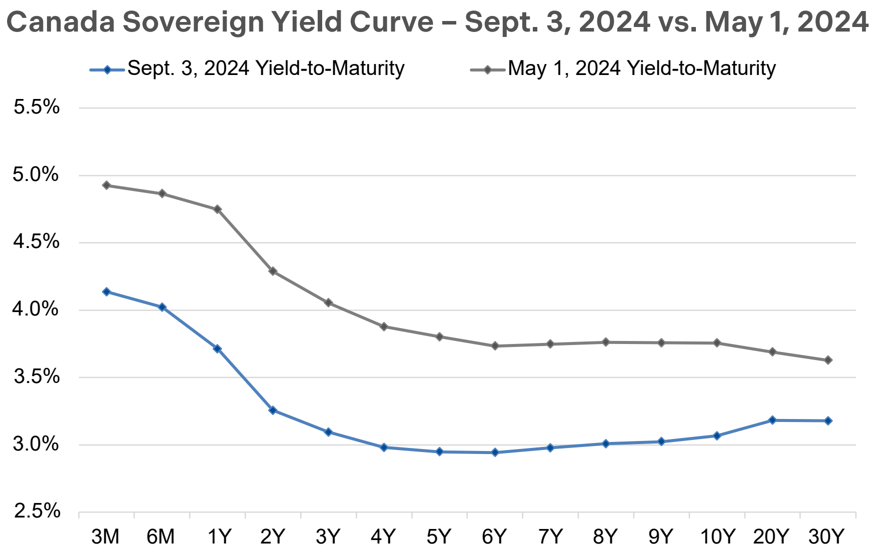
Shift Away from Dividend Stocks Pushed Yields Higher

The rotation out of dividend paying stocks pushed up the yields on sectors that have a higher proportion of dividend paying stocks, as illustrated in the chart below which compares how yield sensitive dividend equities reacted to the sharp rise in interest rates since March 2022.

Sector	Dividend Yield August 2024	Dividend Yield December 2023	Dividend Yield March 2022
TSX Dividend Aristocrats[1]	3.99%	4.09%	3.12%
Equal Weighted Banks[2]	4.60%	5.18%	3.20%
Equal Weighted Utilities[3]	4.53%	4.80%	3.24%
Equal Weighted Real Estate[4]	5.61%	6.08%	3.87%
Equal Weighted Telecom[5]	6.69%	5.68%	3.99%

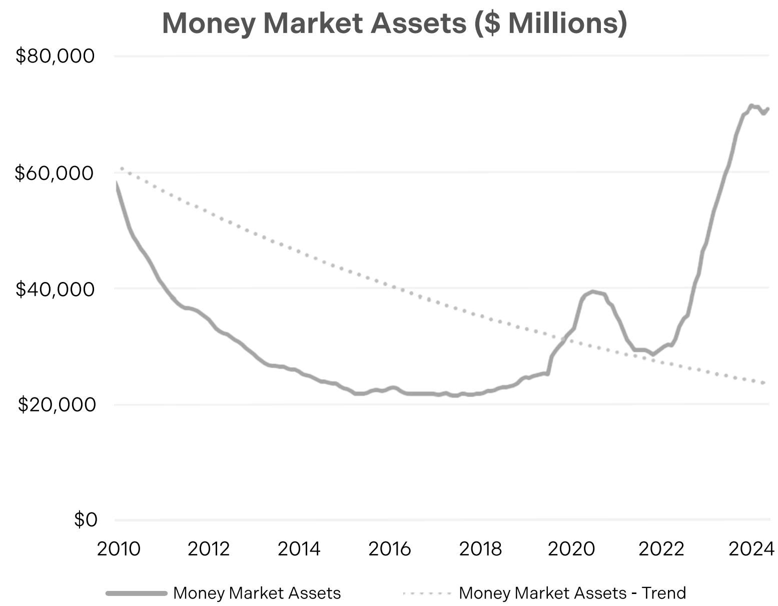
Excess Capital in GICs and Money Market ETFs

As interest rates continue to decline, with the entire Canadian yield curve shifting downwards, we believe funds will flow towards higher-yielding stocks.



Source: Bloomberg, as at August 30, 2024

According to estimates by CIBC, approximately $220 billion of capital, which would have traditionally been invested in dividend paying equities, has been redirected to alternatives like GICs and money market ETFs[6].



Source: CIBC Capital Markets, August 18, 2024

The increase in term deposits during the period of rising rates could potentially flow back into dividend-paying stocks which equates to about 15% of the market capitalization of Canada's Utilities, REITs, Telecoms, and Financials[6].

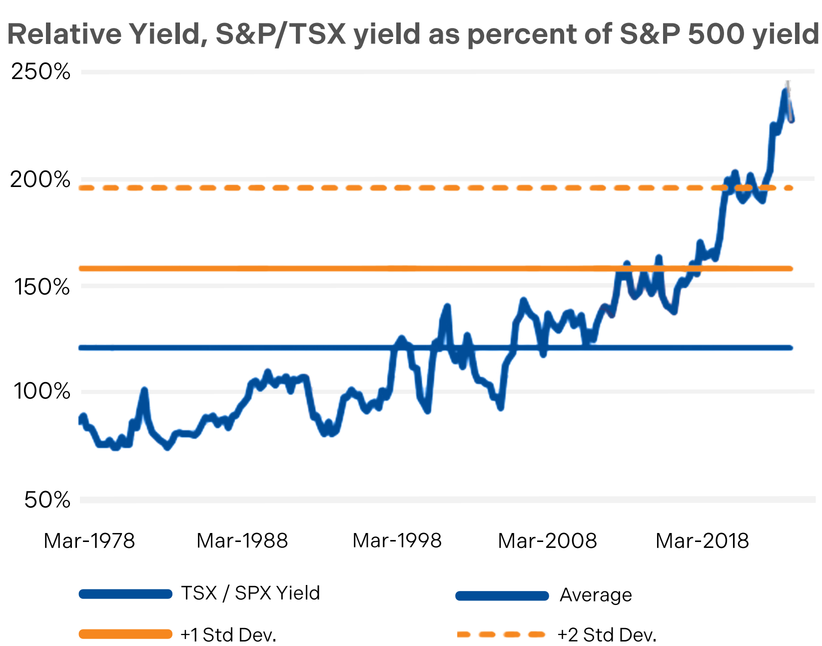
Canadian Excess Yield Liquidity and the Market Cap of Traditional Yield Sectors

Canadian Excess Liquidity			Canadian Yield Equity Market Cap
Term Deposits	$171,952	Real Estate	$75,774
Money Market	$47,629	Utilities	$149,222
		Telecom	$105,311
		Financials	$1,075,030
Total	$219,581	**Total**	$1,405,337

Source: CIBC Capital Markets, August 18, 2024

Dividend Stocks Should Benefit from Declining Interest Rates

In the most recent rate increase cycle, Canadian dividend stocks have sold off more than their U.S. counterparts, primarily because Canadian investors typically seek these stocks for yield, given the lack of alternative options.



Source: CIBC Capital Markets, August 18, 2024

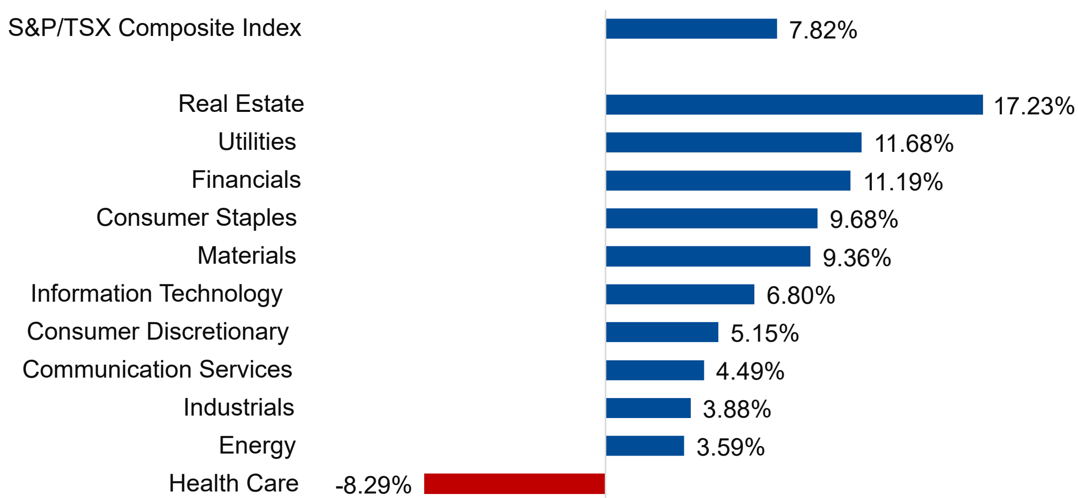
With interest rates now trending downward, we believe this underperformance will reverse. Additionally, the preferential tax treatment of dividends compared to fixed income returns serves as a favourable factor for Canadian dividend-paying stocks[7]. The relative attractiveness of yields on Canadian dividend stocks, compared to U.S. dividend-paying stocks, is at an all-time high, enhancing their appeal to investors.

During periods of economic uncertainty, Canadian dividend stocks have outperformed their U.S. counterparts due to their defensive nature. Notable instances include the onset of the COVID-19 pandemic and the Regional Banking Crises in 2023. With Canada currently experiencing declining GDP per capita, rising unemployment, and declining consumer confidence, investing in more defensive stocks in Canada presents a prudent alternative for investors.

The Rotation Back to Canadian Dividend Stocks has Begun

The recent performance of yield-oriented sectors further underscores this trend. Since the beginning of May 2024, sectors such as Utilities, Financials, and Real Estate have been the top performers on the Toronto Stock Exchange (the "TSX"), surpassing the index's performance as interest rates have come down.

S&P/TSX Composite Sector Total Return Performance
(May 1, 2024 to August 30, 2024)



Source: Bloomberg, as at August 30, 2024

This outperformance highlights the growing investor confidence in these sectors as interest rates decline and economic uncertainty looms. As a result, Canadian dividend-paying stocks are poised to regain their attractiveness and offer substantial opportunities for yield-seeking investors.

Brompton's Approach

Dividend Growth Split Corp. (the "Fund") invests in an actively managed portfolio consisting primarily of large-cap Canadian dividend growth companies. The Fund's class A shares (TSX: DGS) provide investors an opportunity to generate enhanced returns on a portfolio of quality Canadian dividend stocks and receive a high level of monthly cash distributions. Over the last 10-years, DGS class A shares have delivered an 11.6% per annum total return, outperforming the S&P/TSX Composite Index by 4.3% per annum[8].

	Compound Annual Returns			
Compound Annual Returns[14]	**1-Yr**	**3-Yr**	**5-Yr**	**10-Yr**
Dividend Growth Split Corp. (TSX: DGS)	54.8%	17.7%	19.0%	11.6%
S&P/TSX Composite Index	18.7%	7.6%	10.7%	7.3%
S&P/TSX Composite High Dividend Index	15.3%	9.1%	10.4%	6.2%

[1] Bloomberg: iShares S&P/TSX Canadian Dividend Aristocrats Index ETF

[2] Bloomberg: Solactive Equal Weight Canada Banks Index

[3] Bloomberg: Solactive Equal Weight Canada Utilities Index

[4] Bloomberg: Solactive Equal Weight Canada REIT Index

[5] Bloomberg: S&P/TSX Composite Communication Services Sector GICS Level 1 Index

[6] CIBC Capital Markets, August 18, 2024.

[7] TSI Wealth Network, June 28, 2024. How are Dividends Taxed in Canada? Exploring the Canadian Dividend Tax Credit. https://www.tsinetwork.ca/daily-advice/dividend-stocks/how-are-dividends-taxed-the-canadian-dividend-tax-credit/

[8] Returns are for the periods ended August 31, 2024, and are unaudited. Inception date December 3, 2007. The table shows the compound return on a Class A Share for each period indicated compared to the S&P/TSX Composite Index ("Composite Index") and the S&P/TSX Composite High Dividend Index (the "Composite High Dividend Index"). The Composite Index tracks the performance, on a market weight basis, of a broad index of large-capitalization issuers listed on the TSX. The Composite High Dividend Index tracks the performance, on a market weight basis and a total return basis, of 50-75 highest dividend yielding securities within the Composite Index. The Fund invests in an actively managed portfolio and is rebalanced at least annually. It is therefore not expected that the Fund's performance will mirror that of the Indices, which have more diversified portfolios. Further, the indices are calculated without the deduction of management fees, fund expenses and trading commissions, whereas the performance of the Fund is calculated after deducting such fees and expenses. Further, the performance of the Class A Shares is impacted by the leverage provided by the Fund's preferred shares.

Past performance does not necessarily indicate how the Fund will perform in the future. The information shown is based on the NAV per Class A Share and assumes that distributions made by the Fund on the Class A Shares in the periods shown were reinvested (at the NAV per Class A Share) in additional Class A Shares of the Fund.

BROMPTON FUNDS

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