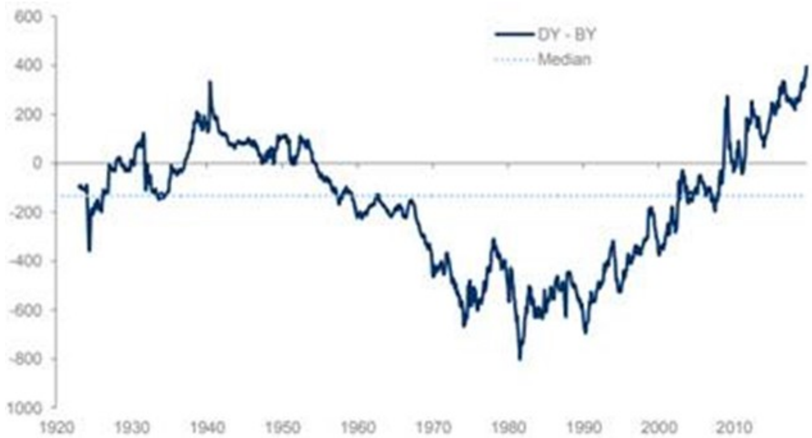
Friday Morning Coffee

Nr. 72 — Paid for waiting

While looking at the daily fluctuations of the stock prices, investors sometimes forget that dividends are a big component of their investment results in the equity markets in the long run. For example, between 1926 to 2015, reinvested dividends explained an impressive 40% of the nominal total return of the S&P 500, a stellar 4% annual return compounding over 90 years ! (source : Ibbotson, Standard & Poors).

The estimated dividend yield for the STOXX 600 for 2020 is currently 4%. This compares to the negative bond yield for the German 30 year and Swiss 50 year government bonds. The yield curve in the US has inverted with the 10 year government bond yielding less than the 2 year bond yield. It is fair to say that we live in unusual economic times. Central banks have taken exceptional measures of quantitative easing, geopolitical uncertainties, recession fears are abundant and tariffs wars are amplified by Tweets. The flight to perceived safety in government bonds has been unprecedented. Almost 30% of the worldwide bonds in issue are currently yielding negative interests, giving investors a guarantee to lose money if these bonds are being held to maturity.

Baron Rothschild, an 18th century British nobleman and member of the Rothschild banking family, is credited with saying that "the time to buy is when there's blood in the streets". The opportunity in European equities in general and European value stocks looks very indeed compelling for a contrarian investor. The spread between bond yields and dividend yields is now the highest over the past 100 years :



Source: Morgan Stanley

Friday Morning Coffee

Nr. 72 — Paid for waiting

At ECP, we are not building portfolios for the mere goal of maximizing dividend yields. We are shying away from most banks, utilities and telcos despite their high dividend yields. However we currently have positions in the portfolio that have unseen dividend yields. Examples are the asset managers Anima and Standard Life Aberdeen, offering current year dividend yields of 5.8% and 9% respectively, the chocolate producer Cloetta with 4%, G4S with 5.8%, Publicis with 5.3% or the oil service provider Wood Group with 7.4%.

We have today the opportunity to buy a portfolio of undervalued quality companies at a historically high discount in European equity markets, a neglected asset class plagued by constant investor outflows. **If we forget about the daily price moves that are more a function of the investor mood and the unpredictable political noise level, we are being paid a solid dividend yield for waiting while our companies continue to produce cash flows. It is certainly not the moment to panic in the value equity space !**

The Morning Coffee will be back on the 20th of September.

I wish you a nice weekend,

Léon Kirch, CFA
Partner & Chief Investment Officer
August 30th, 2019