October 2021

The Case for Canadian Dividends

Dividends have historically been a meaningful component of market returns. This is particularly true in Canada where dividends have comprised 30-40% of TSX Composite Index total returns over the past three decades (Fig. 1). While dividend returns have been dwarfed by price returns in recent years, we believe this has created an attractive setup for dividend-paying stocks to outperform going forward.

Fig. 1: Components of Equity Returns – Select Time Periods

	S&P/TSX Total Return Breakdown			
CAGRs	Price Return	Dividend Return	Total Return	% Div Rtn of Total
30 Year	6.0%	2.6%	8.7%	30.4%
20 Year	5.0%	2.8%	7.9%	36.0%
10 Year	4.7%	3.2%	7.9%	40.5%
5 Year	7.1%	3.3%	10.4%	31.7%
2 Year	11.8%	3.6%	15.4%	23.1%
1 Year	26.9%	3.8%	30.7%	12.4%

Source: CIBC World Markets. Diving Into Canadian Dividends. August 2021.

Equity markets have delivered above-average returns in the past couple of years, and valuation levels are well above the historical mean (as measured by the Shiller price-to-earnings multiple). Should price returns moderate back to long-run averages, which we think is likely to occur, dividend yields will be an increasingly important contributor to performance in the years ahead. History also suggests that dividend-yielding companies have outperformed the broader market during major drawdowns, including the 2000-2001 Tech Bust and the 2008 Global Financial Crisis.[1]

Over the years, accommodative monetary policy and weak economic growth have driven interest rates to record-low levels. The 10-year Government of Canada bond is now offering only a 1.5% yield. This compares to the 2.5% dividend yield currently offered by Canadian equity markets – 20 years ago, the bond yield would have outpaced equity yields by over 300bps! The benefits don't stop there – dividend stocks also benefit from capital appreciation. In a potentially inflationary environment, like the one investors are grappling with today, bonds would be devalued whereas equities have levers to protect against rising prices or grow with the economy. As a result, dividend stocks are relatively attractive in the current environment. Investors otherwise have limited options to derive stable investment income without taking on additional risk.

The opportunity for capital appreciation should not be overlooked, as 30 years of history suggests dividend payers outperform non-dividend payers by more than nine percentage points per year (Fig. 2). Dividends have proven to be a reliable source of tangible returns during periods when stocks don't generate gains. Though dividend-based strategies have underperformed since 2020, further study shows these bouts of underperformance are often temporary and followed by sharp reversals once cash flow concerns subside.[2]

[1] S&P Global. Why Did Dividend Indices Underperform During the Coronavirus Sell-Off?
[2] BMO Capital Markets. Dividend Growth Can Mitigate Interest Rate Risks, March 2021.

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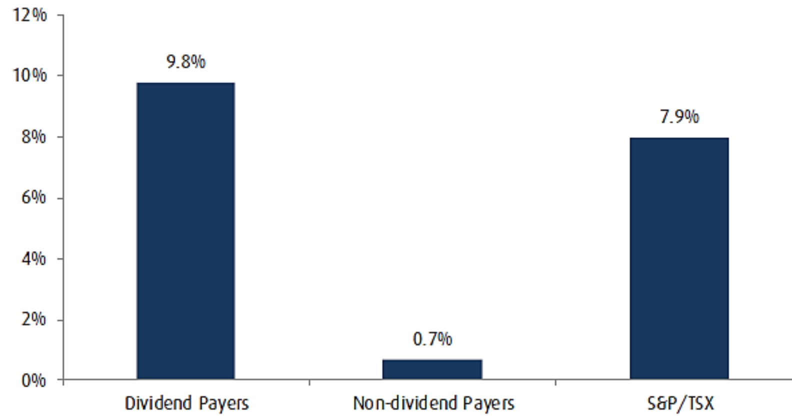
Fig. 2: Total Returns Since 1990

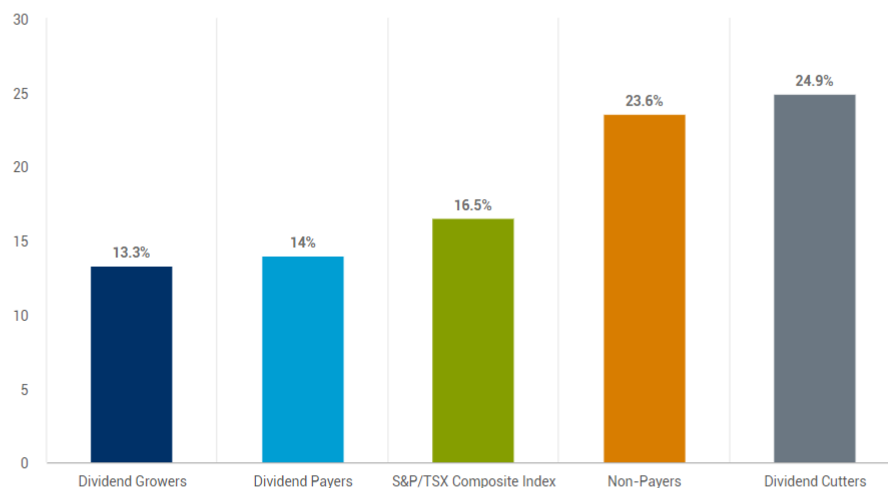


Source: BMO. Dividend Growth Can Mitigate Interest Rate Risks. March 2021.

In addition to higher yields and higher returns, dividend-payers have historically been less volatile than their non-dividend-paying peers. Canadian dividend companies tend to be stable, predictable businesses with a track record of strong revenue, earnings and cash flow. Such companies are known to provide downside protection during downturns or volatile markets (Fig. 3). From a corporation's perspective, paying a consistent dividend instils capital discipline upon the management team, which helps create durable, value-creating business models.

Fig. 3: Dividend-Paying Stocks Have Displayed Lower Volatility

Annualized Volatility (1986-2020)



Source: RBC Capital Markets. The Power of Dividends.

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Investors often raise the concern that dividend-yielding companies will be disproportionally hurt by rising interest rates. A closer look at history shows this is not the case. Between 1960 and 2018, which includes a multi-decade inflationary run, high dividend-paying companies outperformed the market in seven out of ten observed rising rate regimes. When taking the average performance of all inflationary instances, high-dividend stocks have outperformed the market by an annualized 0.80% (Fig. 4).

Fig. 4: Average Performance in Inflationary Periods Since 1960

Studied Time Period	Number of Inflationary Months	US 10-Year Treasury Increase (bps)	High Dividend Portfolio Return	S&P 500 Return	Difference in Returns
1960 – 2018	29	290	12.55%	11.76%	0.80%

Source: Capital X Management.

Within Sionna's mandates, we hold many exemplary Canadian companies with strong track records of delivering dividend yield and dividend growth. For instance, Telus Corporation is one of the three largest telecommunications companies, providing an essential service to Canadians. The company has raised its per-share dividend in 19 of the last 20 years. It currently offers an attractive 4.5% dividend yield, while also producing meaningful additional capital appreciation over time. The dividend is supported by its stable asset base and well-managed operations.

Another impressive dividend-paying company is TC Energy, whose vast infrastructure assets provide hydrocarbon transport across North America. We hold this stock across several Sionna mandates. Its stability is underpinned by the longevity of its pipelines and long-term contractual payments. The company pays a 5.4% dividend yield – imagine starting off the year with a 5.4% return in the pocket! – and has raised its dividend every year for the past two decades. Despite being in the energy sector, we believe TC Energy has an incredibly safe dividend.

The case for Canadian dividends is compelling. In today's investment environment, characterized by a combination of low interest rates and heightened market volatility, traditional sources of investment income appear inadequate. We would advocate complementing your portfolio with a robust, diversified set of dividend-paying equities. When combined with Sionna's style of selecting high-quality, attractively valued companies, our clients will likely continue to be paid attractive dividends that should increase over time.

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