

Active Dividend Management is Forward-Looking

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 Miller/Howard Investments

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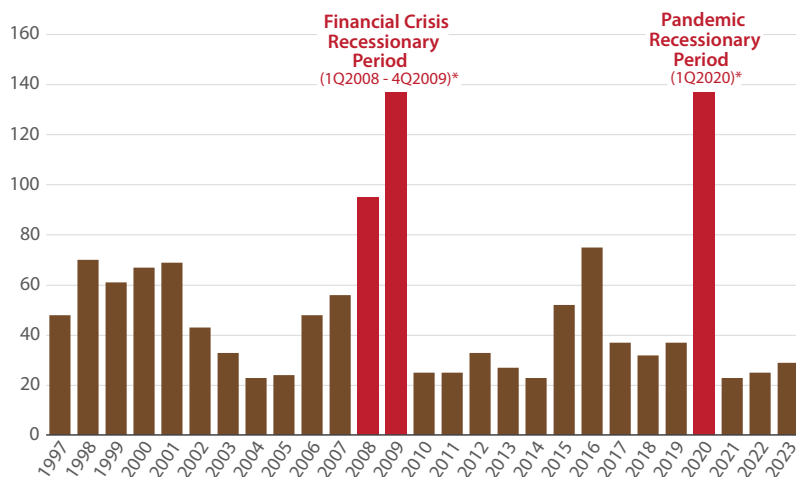
One of the continuing debates in investing is the relative merits of active versus passive management. While, as active managers, we admit that we are biased, we thought that we'd review what we perceive to be the benefits of active management.

Passive portfolios follow indices that are based on history. For example, an index might have a rule that it will invest in companies that have raised their dividend every year for the last 10 years. While we think that a history of dividend increases is a good thing, and often look for it in our own stocks, we have all seen the caveat that past performance is no guarantee of future returns. In fact, we often adjust that adage to say, "past dividends are no guarantee of future dividends." We buy (or hold) a stock for its future prospects—not those of its past. Nothing that we do today can capture yesterday's performance. Investors need to analyze the future more than the past. Periodically, this has been a fatal flaw of passive investing.

Active versus Passive. Acting versus Reacting.

During the Great Financial Crisis (2007-2008), most investors could see that many highly-leveraged companies would need to reduce their dividend payouts to conserve cash. This was especially true for many financial companies. In fact, regulators publicly said as much. Active investors were able to sell the potential dividend cutters and reposition their portfolios. Passive portfolios, often accessed through ETFs, had to await the next scheduled index rebalance date in order to sell companies that had cut their dividends. What's more, if an obvious potential cutter hadn't yet formally announced their cut, the ETF would have to wait until the next rebalance date after the

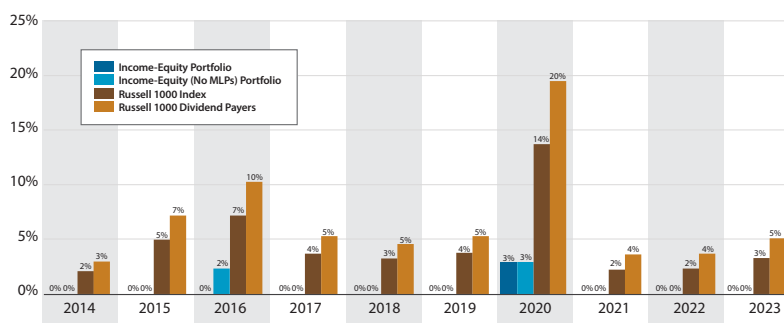
Dividend Decreases by Calendar Year (Russell 1000 Index Members)



As of December 31, 2023. Sources: LSEG; Federal Reserve Bank of St. Louis; Miller/Howard Research & Analysis. For the Russell 1000 Index, we considered all members of the index as of the prior year-end date. Decreasers had a 4th quarter dividend lower than the prior year's 4th quarter dividend. Semi-annual payers were included but analyzed using full-year dividends. Specials were excluded from our calculations.

*Recessionary Period as defined by National Bureau of Economic Research (NBER).

Dividend Decreases as a Percent of Holdings



As of December 31, 2023. Sources: LSEG; Miller/Howard Research & Analysis. For the numerator, we count the number of holdings that declared an increase (while held in a Miller/Howard portfolio) during the period. For the denominator, we calculate an average number of holdings using our holdings count as of each quarter-end for the period. We define Russell 1000 Index Dividend Payers to be those companies that paid a dividend in the prior 4th quarter. For the Russell 1000 Index Dividend Payers, decreasees had a 4th quarter dividend lower than the prior year's 4th quarter dividend. Semi-annual payers were included but analyzed using full-year dividends. Semi-annual payers were included if a dividend was paid in the second half of the prior year. Specials were excluded from our calculations.

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announcement, which typically occurs every 12 months. These delays in exiting dividend cutters weighed on both income and principal returns.

More recently, during the pandemic, companies that depended on in-person business (airlines, cruise lines, hotels, restaurants, retail stores, commercial landlords, etc.) were forced to close, leaving them with little to no revenue and unable to pay their pre-pandemic level of dividends. Again, active managers could evaluate each company's financial and fundamental situation and act to adjust their portfolios. Passive ETFs had to wait until after the dividend (or earnings) cuts before reacting. Active vs. passive; acting vs. reacting.

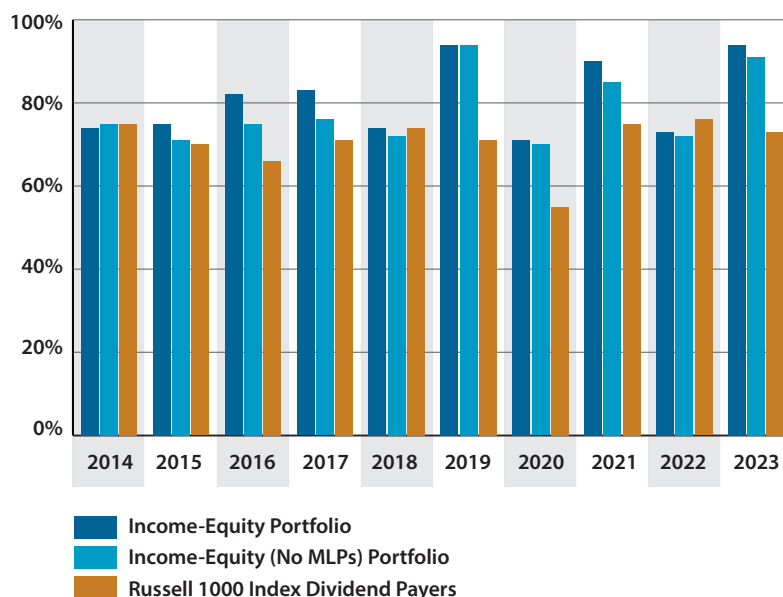
Using dividend cuts as a proxy for when a company gets into financial distress, forward-looking active management has done better job avoiding troubled stocks than has rearward-looking passive management. Portfolio managers can also use fundamental analysis to identify stocks with prospects for dividend growth.

Each Investor is an Individual

Passively following an index requires an investor to believe that that index is the solution to achieving their particular investing goals. We've met many investors who are trying to satisfy a financial need; we've never met an investor who wants to be like this or that index. Perhaps an individual is saving for a child's education or funding their retirement, or maybe they represent an institution that needs income for charitable spending or growth for a future capital project.

Before deciding to mimic some index, the investor should ask themselves if that index is the best way to meet their needs, or if they'd be better served by a more tailor-made solution than by a generic one. We believe a retiree probably isn't well served by having their nest egg in a broad market index. Sure, they need growth, but they probably need income more than they need to participate in the overall growth in the US economy. Saving for education or a future capital project might be served by investing in the broad market, but is the investor's risk tolerance the same as that of the index? Could that investor be better served by compounding income as the lower-risk way to achieve the same goals?

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We believe a separately managed portfolio can better match an investor's risk tolerance. Rather than getting an index's generic level of volatility, with a separately managed portfolio the investor doesn't have to accept a "market" level of risk or volatility, but one with which the investor is comfortable. It is hard to overstate the importance of matching the investor's risk tolerance with their portfolio level of risk. If the portfolio has too low a level of risk, the investor could fail to meet their investing goals. If the portfolio has higher volatility than the investor can tolerate, then they are likely to cash out at exactly the wrong time after the index has declined and be reluctant to reinvest and thus miss any rebound. Remember, successful investing isn't about timing the market, but about time in the market. A comfortable level of risk can help an investor sleep well at night even during a rough patch and, importantly, keep them invested when things turn around.

Ultimately, each investor needs to determine their own investment style and needs. However, in unsettled times, when investment regimes are in flux—such as now when the career-long interest rate decline has ended or when long dormant inflation may be reawakening—we believe the ability to be proactive with an investment strategy that is tailored to your needs could provide much better results than just continuing to do what has worked in the past in a generic investment product. ■



John E. Leslie III, CFA
Portfolio Manager

John E. Leslie III, CFA, Portfolio Manager, focuses on diversified, dividend-paying stocks. He is a member of Miller/Howard's Board of Directors. Prior to joining Miller/Howard in 2004, Jack was a portfolio manager at Value Line Asset Management, M&T Capital Advisors Group (a division of M&T Bank Corp.), and Dewey Square Investors Corp. (now part of Old Mutual Asset Management). Jack earned his BS in Finance from Suffolk University and an MBA from Babson College.

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