Miller Howard
INVESTMENTS

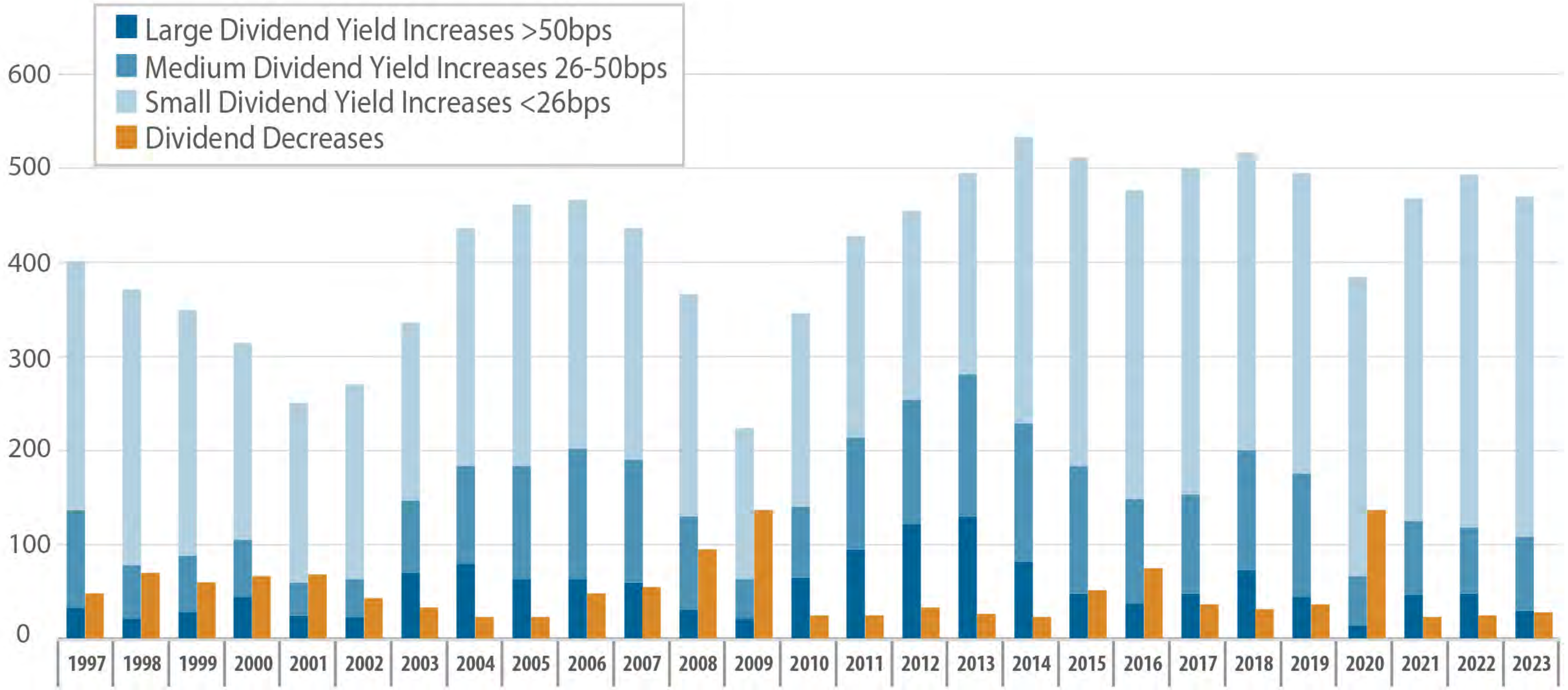
Dividend Growth: The Underappreciated Tailwind

QUARTERLY REPORT 4Q 2023

In some ways 2023 was a truly unique year—war, social discord, and gyrating financial markets. But from the standpoint of dividend increases, the year was a yawner. Just like in virtually every other year, roughly half of the companies in the Russell 1000 Index raised their dividend. Among 2022 dividend payers, almost three-quarters announced dividend increases in 2023. For those looking to build wealth without drama, dividend increases provide an unappreciated tailwind, gradually driving income higher over time.

Dividend Growth—The Underappreciated Tailwind

Russell 1000 Index Calendar Year Dividend Changes



As of December 31, 2023. Sources: Refinitiv; Miller/Howard Research & Analysis. Analysis based on Russell 1000 Index dividend payers, defined as stocks in the Russell 1000 as of the prior year-end that paid a dividend in the 4th quarter of that prior year. To calculate dividend action in basis points, we subtracted the prior year 4th quarter dividend from the current-year 4th quarter, and then multiplied by 4 to annualize. The result was divided by the stock price at the prior year-end and then multiplied by 10,000 to convert to basis-points (bps). (Semi-annual payers were adjusted accordingly. Specials were excluded from our calculations.)

Higher interest rates have magnified the importance of dividend increases for investors. For the decade prior to the current Fed tightening cycle beginning in 2022, it was relatively easy to construct an equity portfolio with an initial dividend yield above the interest rate on 10-year Treasury bonds. Now that interest rates are higher, buy-and-hold equity investors must rely on dividend increases to ensure that portfolio income overtakes what they could have earned on a bond portfolio.

Naturally, not all dividend increases are equal. Portfolios with larger dividend increases will grow their income faster.

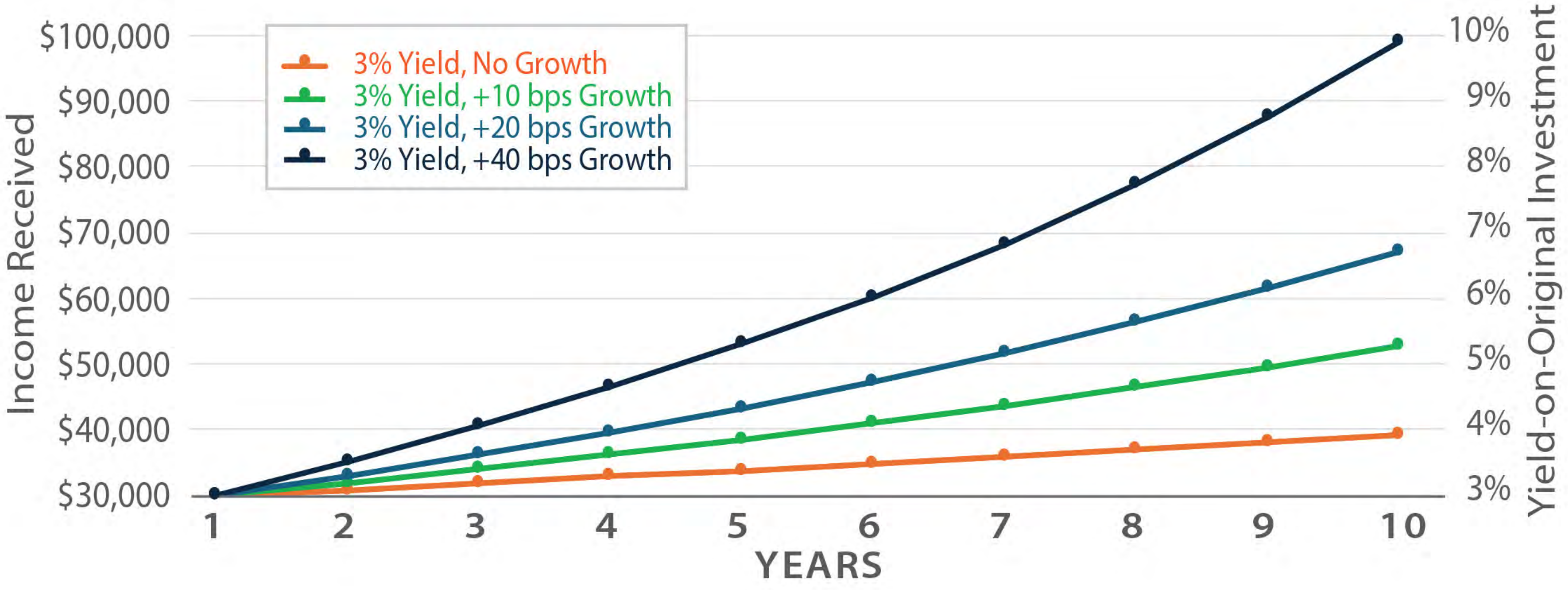
But how should we measure the size of a dividend increase?

Percentage increases are commonly used, but that can be very misleading, particularly for expensive stocks. Nvidia (not held) pays a dividend of $0.04 per quarter. If Nvidia doubled its dividend, its dividend yield would rise from 0.03% to 0.06%—a trivial increase. We prefer using bond conventions to describe increases. A dividend going from 0.03% to 0.06% is a 3 basis point increase, which is indeed small. In 2023, the median dividend change in the Russell 1000 was 11 basis points. If an investor managed to avoid dividend cutters and those companies holding the dividend flat (no easy feat!), the median dividend increase would rise to 16 basis points. On a million dollar portfolio, a 16-basis-point hike generates a $1,600 increase in income. At Miller/Howard, our income growth goals are higher.

Fortunately, every year there are dividend increases that are much larger than 16 basis points. We define increases as "large" (exceeding 50 basis points), "medium" (between 26-50 basis points), and "small" (less than 26 basis points). Every year, there are medium and large increases, and those sizeable increases provide a strong tailwind to overall portfolio income.

The Power of Compounding Growth

Dividends Received Over Time with Dividend Reinvestment*



Source: Miller/Howard Research & Analysis.
*Hypothetical $1 million initial investment with a 3.0% yield, at various basis points (bps) growth rates.

To demonstrate the power of dividend increases, let's start with a portfolio that has a 3% yield and no increases. If dividends are reinvested, the portfolio will yield 3.9% on the original investment after 10 years. (Note, the result would be same for a bond portfolio with a 3% yield.) If dividends increase by a measly 10 basis points per year, by the tenth year, with reinvested dividends, portfolio income would be 5.3% of the original investment. With 20 basis points of dividend increases, the yield on original investment would be 6.7%, more than double the beginning yield. A portfolio with 40 basis points of annual dividend increases would see annual income rise to 9.9% of the original investment, more than tripling the beginning yield.

Annual dividend increases can compound up to substantially higher income, but that requires successfully tilting a portfolio towards larger dividend increases and, importantly, avoiding dividend cuts. Most cuts are to zero, meaning full elimination of the dividend.

Every year offers opportunities for both significant dividend increases and income-destroying cuts, so what stock characteristics give us the best chance to grow dividends and stay clear of cuts?

What Characteristics Best Forecast Good Dividend Growth?

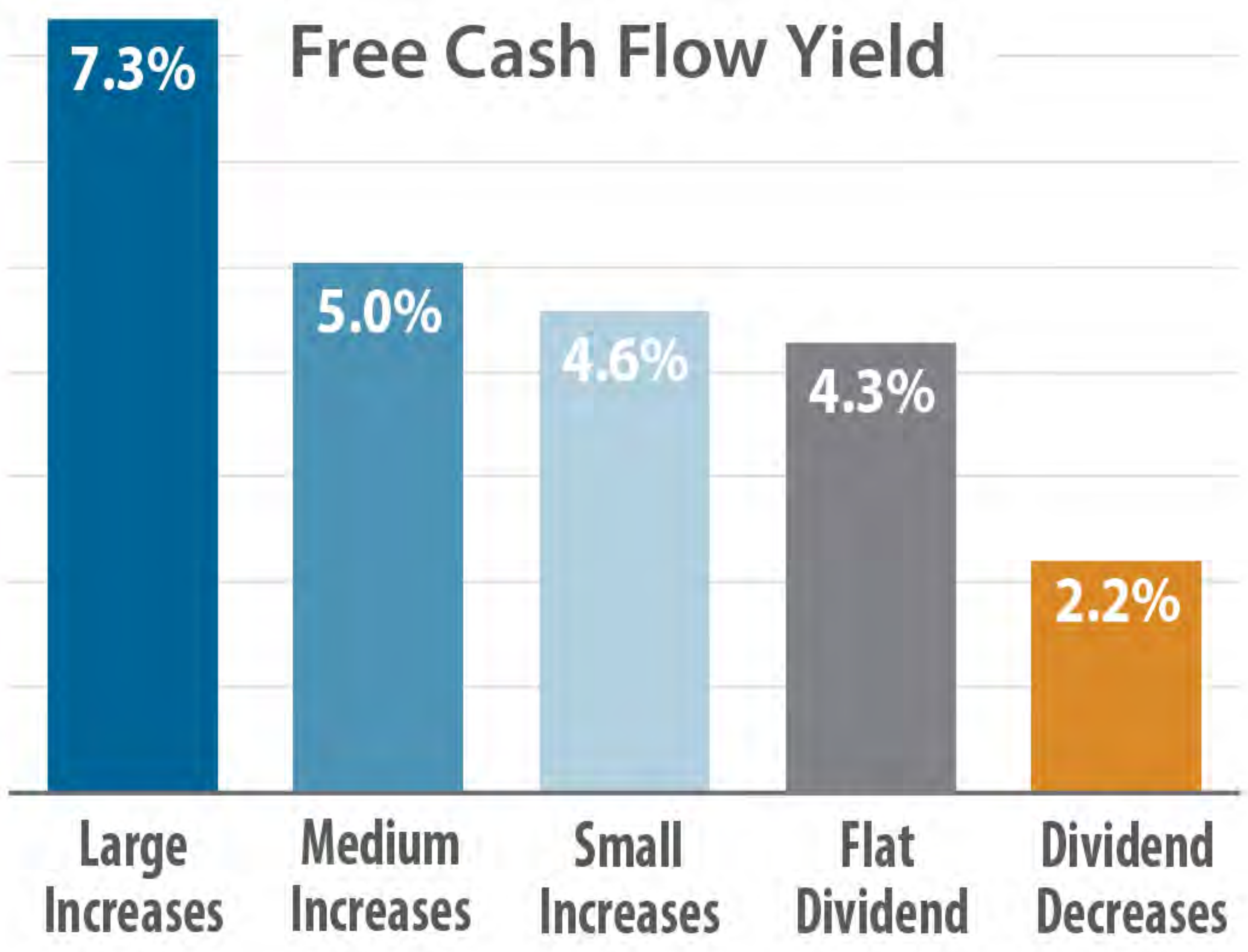
To answer this question, we have compiled the dividend paying behavior of Russell 1000 Index stocks going back to 1997. Every year, typically 600-700 of the companies paid a dividend in the previous year.

What best predicts the chance of those companies either increasing or cutting their dividend?

• Higher free cash flow (FCF) yields historically have been associated with a greater likelihood of dividend increases and a lower chance of cuts. Moreover, companies with higher FCF yields have tended to announce larger dividend increases.

Free cash flow is the amount of cash flow a company generates after capital spending. Dividends require cash, so it is no surprise that it is linked to good dividend behavior. FCF yield is defined as free cash flow per dollar of market capitalization. It's a valuation metric, as a high FCF yield means that investors are getting more free cash flow per dollar invested.

Forecasting Dividend Growth Historically (1997-2023)

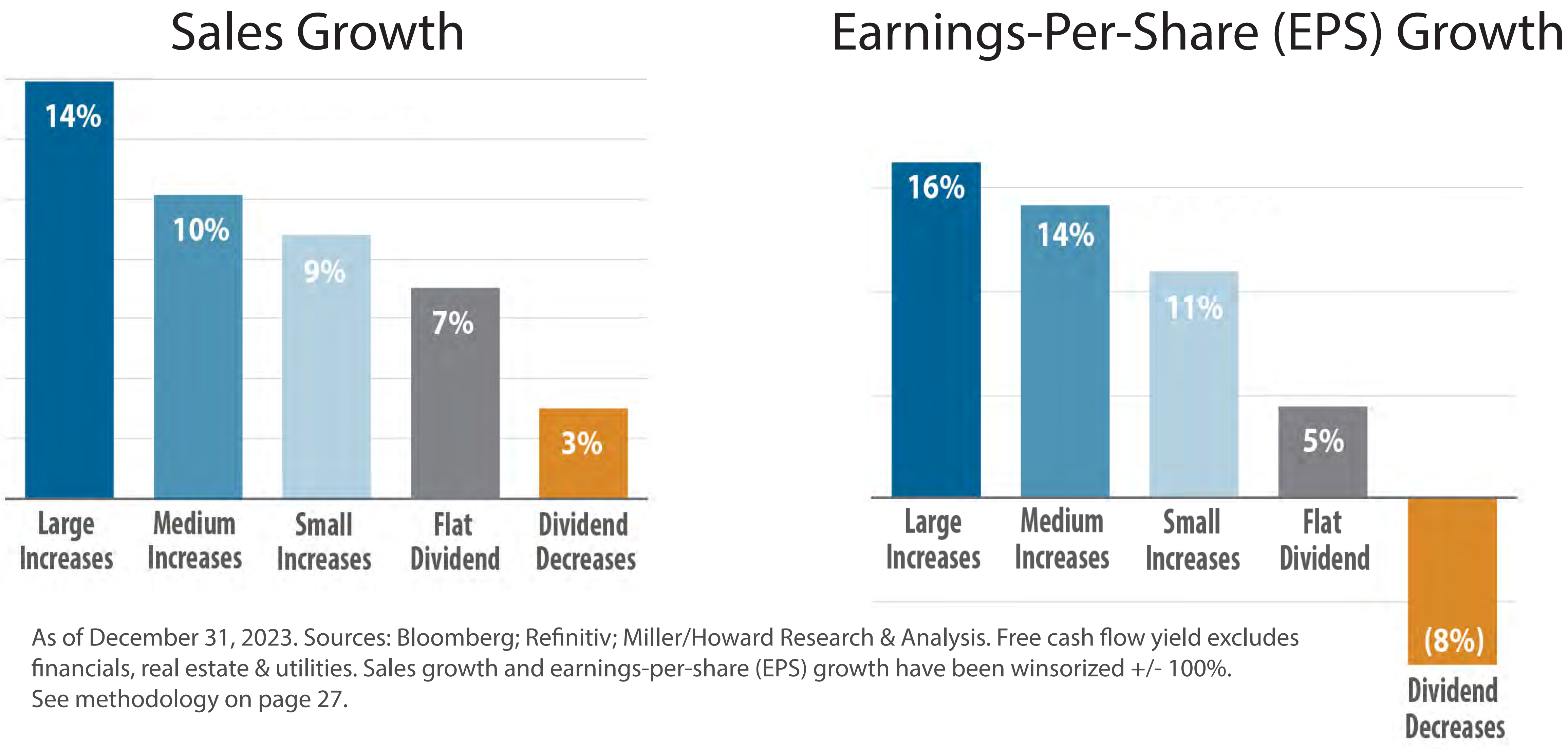


As of December 31, 2023. Sources: Bloomberg; Refinitiv; Miller/Howard Research & Analysis. Free cash flow yield excludes financials, real estate & utilities. Sales growth and earnings-per-share (EPS) growth have been winsorized +/- 100%.
See methodology on page 27.

• Higher sales and earnings-per-share growth historically have led to larger dividend increases and a lower chance of dividend cuts.

These results simply say that, based on historical trends, buying healthy, growing businesses at reasonable prices is the best route to seeing meaningful dividend increases in your portfolio.

Forecasting Dividend Growth Historically (1997-2023)

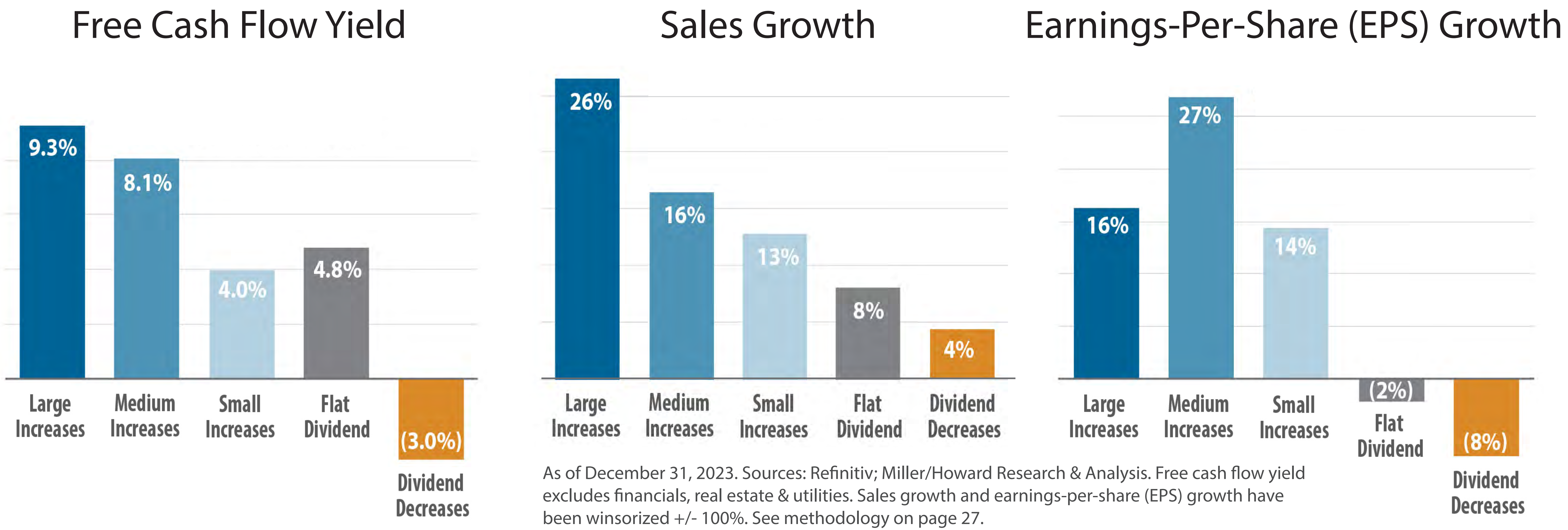


As of December 31, 2023. Sources: Bloomberg; Refinitiv; Miller/Howard Research & Analysis. Free cash flow yield excludes financials, real estate & utilities. Sales growth and earnings-per-share (EPS) growth have been winsorized +/- 100%.
See methodology on page 27.

At Miller/Howard, we combine fundamental research with quantitative analysis that focuses on the same themes of free cash flow, revenue growth, and EPS growth—but from a forecasting perspective. Will high free cash flow continue? Will revenue and EPS grow in the coming years? The details vary by firm and industry, but our focus remains on finding healthy, growing companies.

Clients sometimes push back on conclusions based on averages over multiple decades, asking whether the highlighted factors still work in the current market. Looking back, the patterns for 1997-2023 largely held for 2023, albeit with a bit of noise. Companies announcing large dividend increases in 2023 entered the year with the best free cash flow yield, the best sales growth, and the second-best EPS growth. Medium dividend increasers had the second-best FCF yield and sales growth, and the best EPS growth.

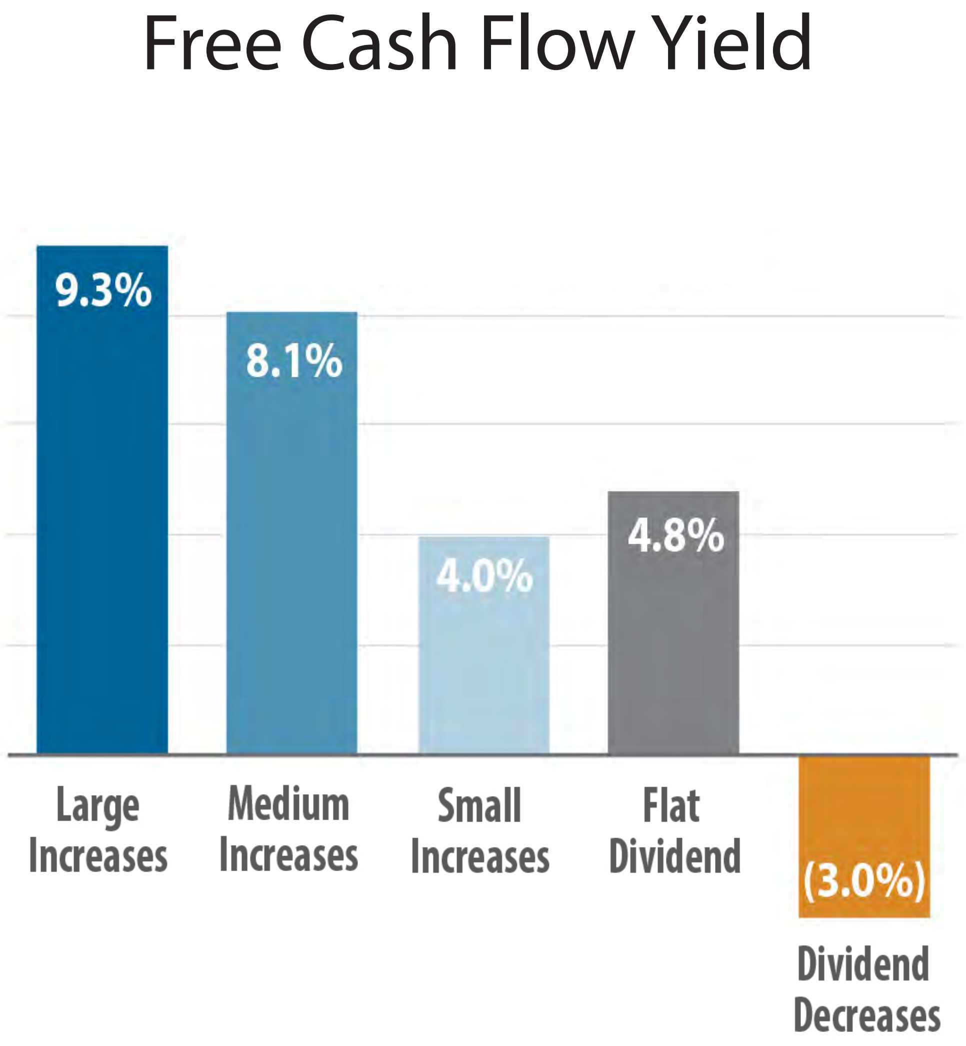
Forecasting Dividend Growth: 2023

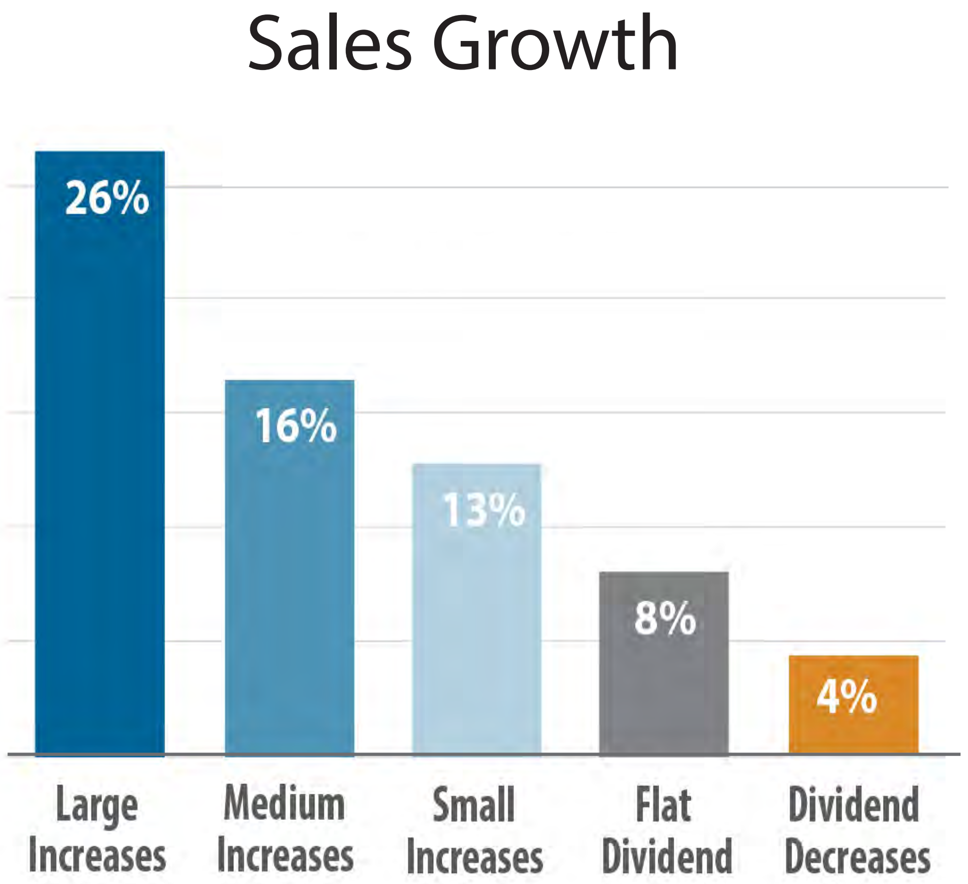


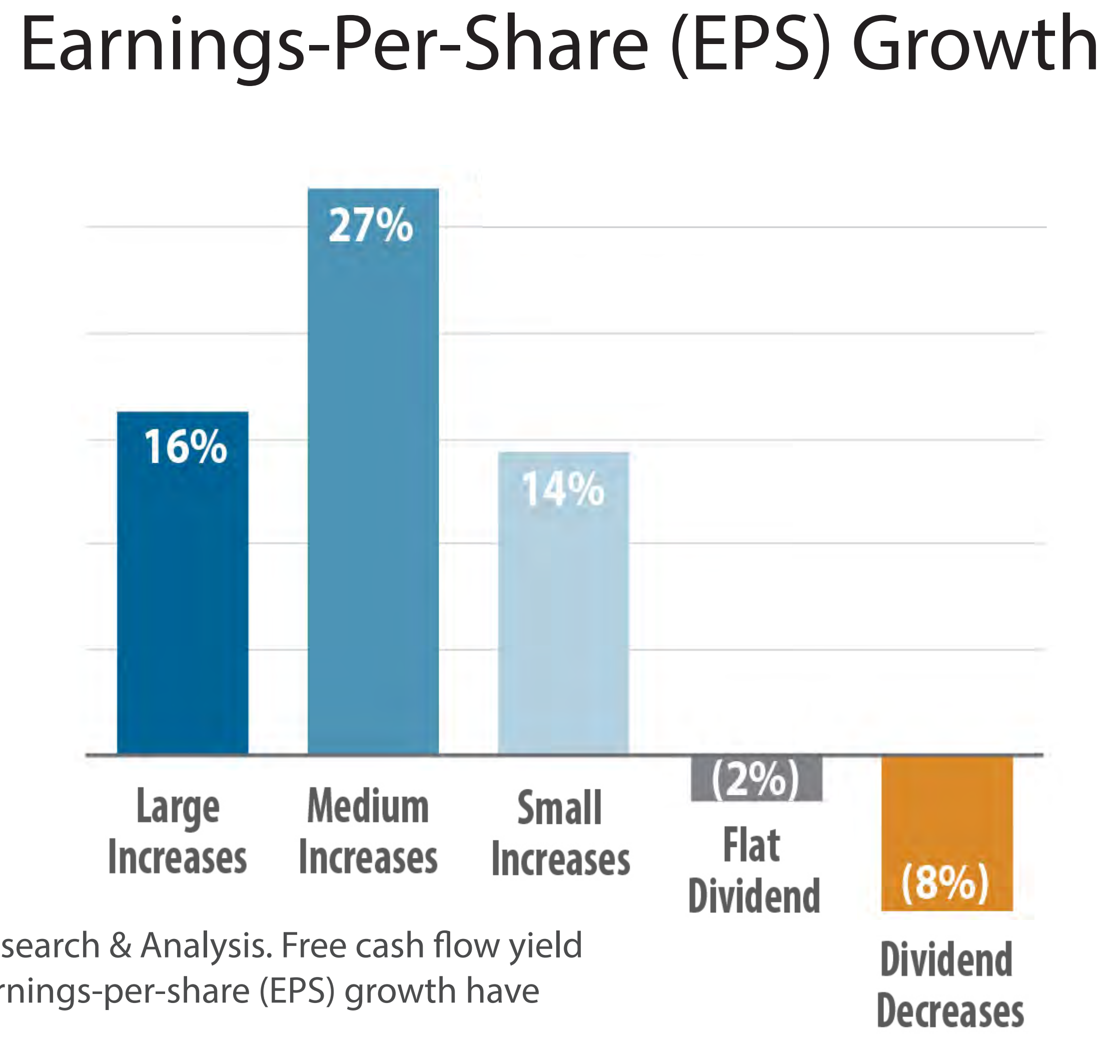
As of December 31, 2023. Sources: Refinitiv; Miller/Howard Research & Analysis. Free cash flow yield excludes financials, real estate & utilities. Sales growth and earnings-per-share (EPS) growth have been winsorized +/- 100%. See methodology on page 27.

The remainder of the results were largely in line, but with a few wrinkles. Small dividend increasers entered the year with better sales and EPS growth than those companies that held dividends flat. Free cash flow yield for small increasers was slightly below those holding the dividend flat, contrary to long-term experience.

Forecasting Dividend Growth: 2023



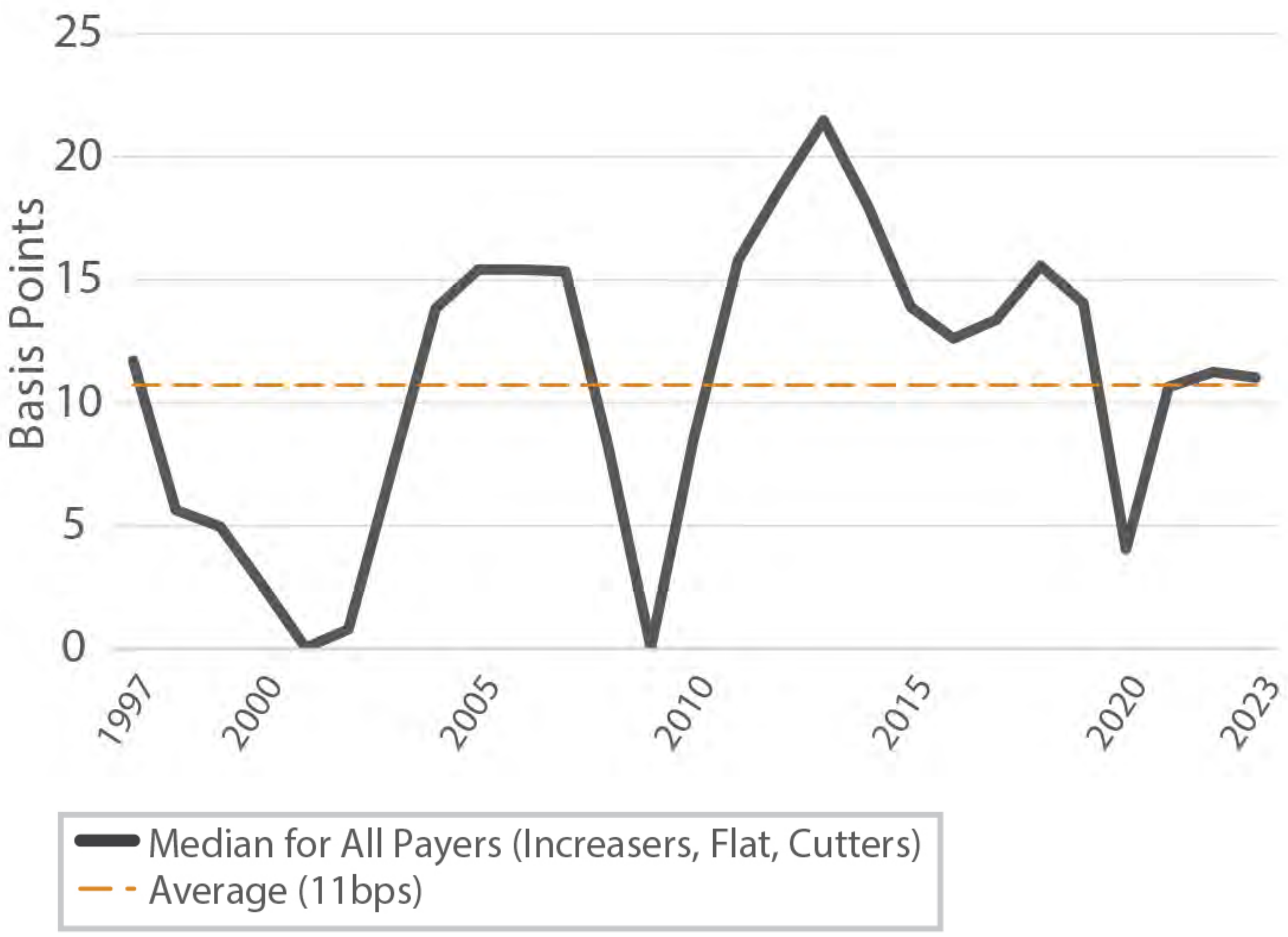




As of December 31, 2023. Sources: Refinitiv; Miller/Howard Research & Analysis. Free cash flow yield excludes financials, real estate & utilities. Sales growth and earnings-per-share (EPS) growth have been winsorized +/- 100%. See methodology on page 27.

Median Dividend Change

Russell 1000 Index Payers



As of December 31, 2023.
Sources: Bloomberg; Refinitiv; Miller/Howard Research & Analysis.

There were 29 dividend cutters in the Russell 1000 in 2023. Those companies entered 2023, on average, with negative free cash flow (worse than companies that raised or held dividends flat), consistent with our long-term conclusions. Dividend cutters entered the year with lower sales and EPS growth than those companies that raised dividends, again consistent with the long-term results.

Overall, 2023 was a typical year for dividend increases, both in frequency and the fact that the median dividend change for the Russell 1000 was only 11 basis points, well below the level in all Miller/Howard strategies.

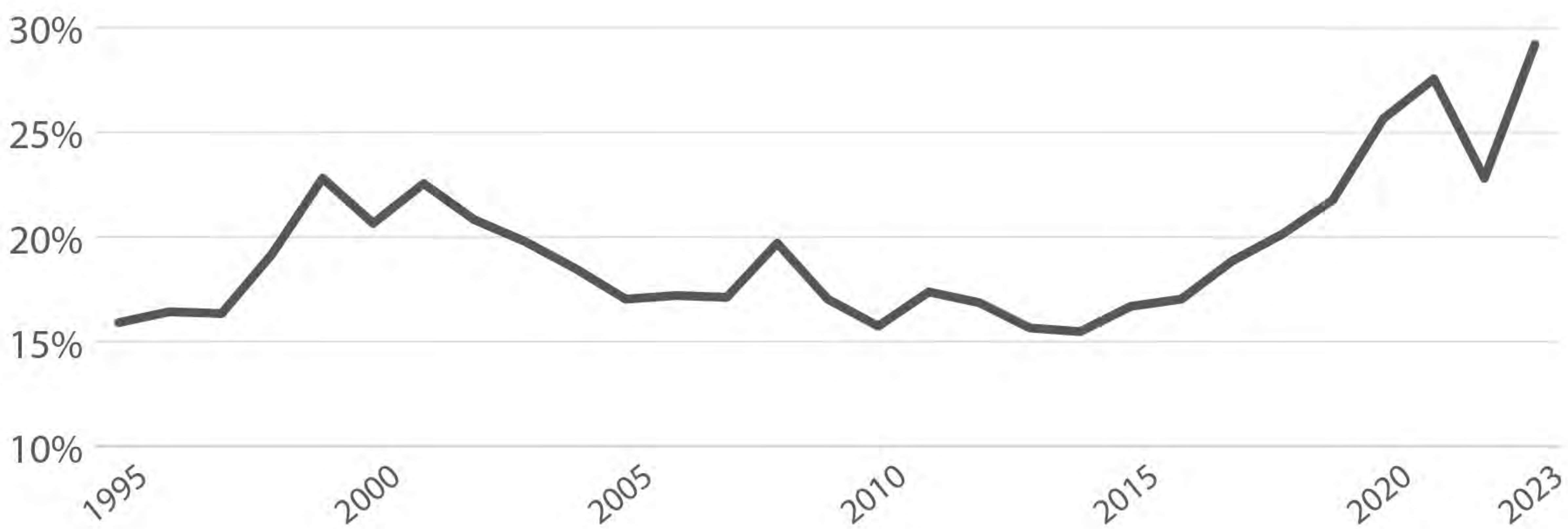
Dividend increases were in line with historical norms in 2023, but the total performance of dividend-paying stocks lagged the market significantly. We have shown in the past that high-yield-dividend stocks, defined as deciles 7-9 of dividend yields, have usually outperformed the broad market over long holding periods. *(See for example, Miller/Howard 1Q 2022 Quarterly Report.)* In 2023, however, the broad market outperformed high-yield-dividend stocks significantly.

Performance was highly concentrated in 2023, with the Russell 1000 total return largely driven by seven stocks linked to artificial intelligence: Microsoft, Apple, Nvidia, Amazon, Meta, Tesla, and Alphabet.‡ These large-cap tech stocks dominated the Russell 1000 to such an extent that the (normal) market-cap weighted version of the index had a significantly higher total return than the equal-weighted version of the Russell 1000. Same stocks, just different weights.

‡As of December 31, 2023, Tesla was held in a Miller/Howard portfolio that is not yet available to investors. The rest of these companies were not held.

Unusually High Concentration Risk in the Market

Weight of the Russell 1000 Index Top 10 Holdings

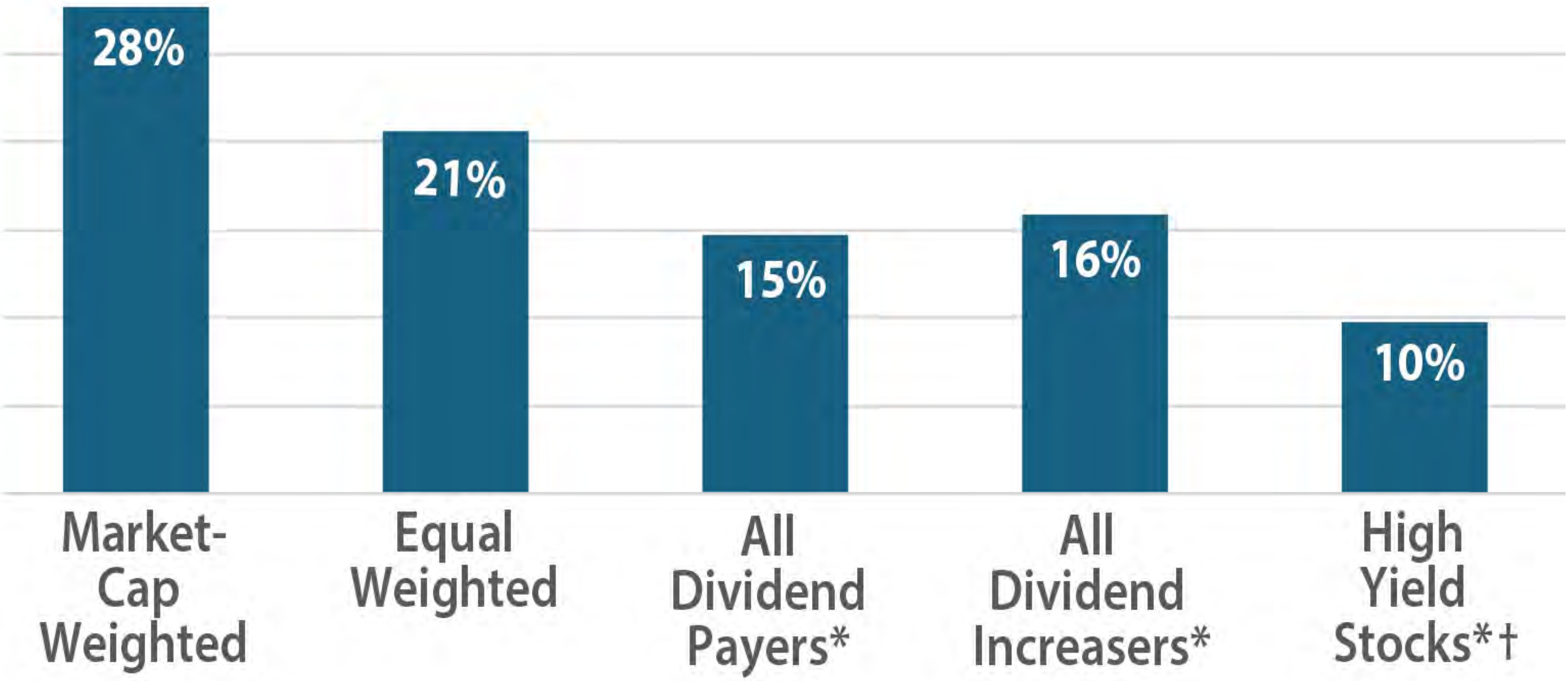


As of December 31, 2023. Source: Bloomberg. Note: We ran two screens for members of the Russell 1000 Index by calendar year end date. Members were ranked by market capitalization where 1 was the highest. The first screen was limited to the top 10 by market cap. The second screen was all other members. The total market cap of each selection period was used to calculate top ten percent totals. Stocks with multiple classes (e.g., Alphabet) were combined so as to include their market captilization once in the total sum.

The combined weight of the top 10 stocks in the Russell 1000 is now over 29%, the highest in decades. This list of stocks is dominated by tech stocks with high price-to-earnings multiples and small or no dividends. Success or failure with these highflyers depends on the companies hitting aggressive financial forecasts for decades to come.

2023 Market Performance Driven by Mega Caps

Russell 1000 Index Member Returns



As of December 31, 2023.
Sources: Bloomberg; Refinitiv; Miller/Howard Research & Analysis.
* Equal weighted.
†Deciles 7 through 9. Russell 1000 Index members and weights were determined using market capitalization at December 31, 2022.
All Dividend Payers: those stocks that paid a dividend as of the fourth quarter of 2022 (adjusted for annual & semi-annual payers).
All Dividend Increasers: See the methodology outlined in the foonote for the chart on page 27.
High Yield Stocks: We calculated the indicated yield using the 2022 dividend calculated for "All Dividend Increasers" as the numerator and the last price as of December 31, 2022 as the denominator. The resulting yields were then deciled where 10 was the highest yields and 1 the lowest.

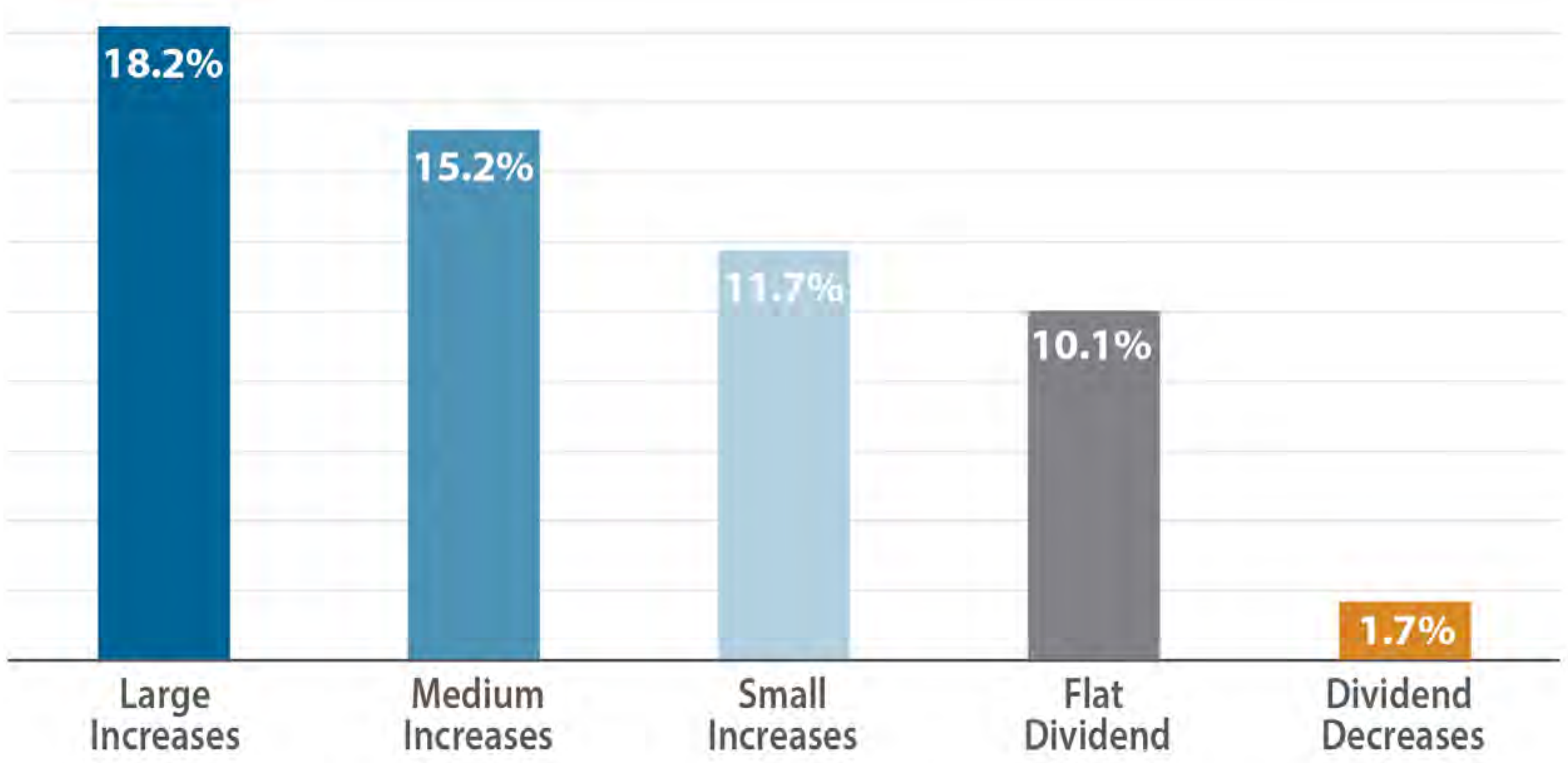
Dividend paying stocks trailed the broad market with high-yield-dividend stocks lagging lower-yielding peers. Higher interest rates may have been a headwind for bond proxy stocks—those with high yields but little or no dividend growth. Dividend growers had roughly the same total return as all dividend payers, a result that is contrary to the long-term superior returns of dividend growers.

Do Dividend Increasers Outperform?

Among dividend-paying stocks, it seems intuitive that dividend increasers would have better total returns, and indeed, historcially that is true. Looking back to 1997, the average total return for companies announcing large dividend increases was highest, followed by companies announcing medium dividend increases, and followed by companies announcing small dividend increases. Companies holding their dividend flat underperformed dividend increasers. Bringing up the rear, dividend cutters had the lowest average total return.

Larger Dividend Increases Correlate with Better Same-Year Returns

Total Returns by Dividend Action (1997-2023)



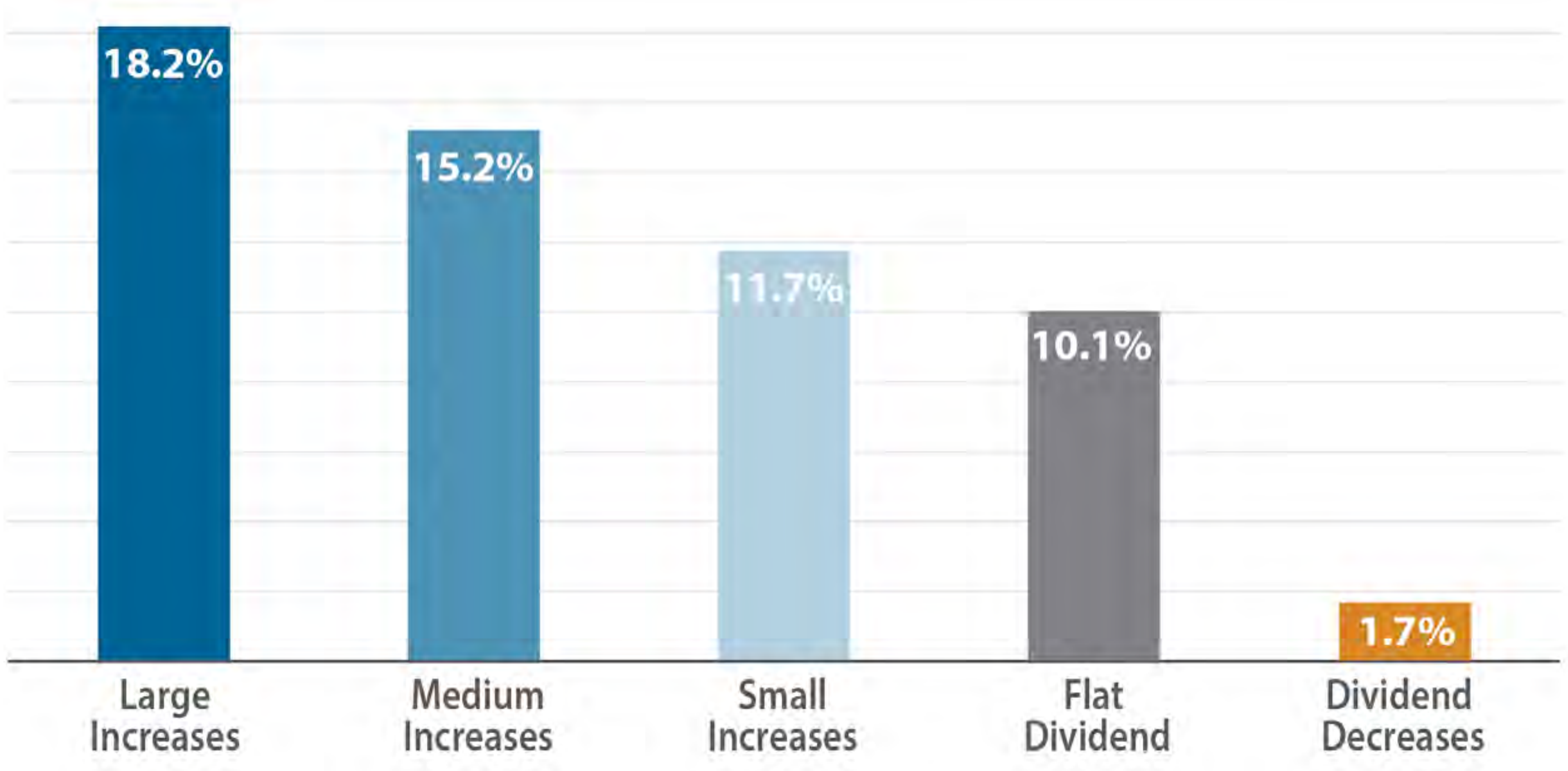
As of December 31, 2023. Sources: Refinitiv; Miller/Howard Research & Analysis. We looked at the average calendar year total return for Russell 1000 Index dividend payers based on dividend action profile taken that year (Large, Medium, Small, Flat, Decrease). We then calculated a compound annual growth rate (CAGR) for each profile. See methodology on page 27.

These are "same year" results, meaning that companies that announce dividend increases during the year also tend to have better total returns. Bigger dividend increases are associated with even better total returns.

Studies of dividend cutters frequently conclude that they underperform in the quarters leading up to the dividend cut. Our results are consistent—companies that cut their dividend in a particular year also tend to underperform significantly in that same year.

Larger Dividend Increases Correlate with Better Same-Year Returns

Total Returns by Dividend Action (1997-2023)



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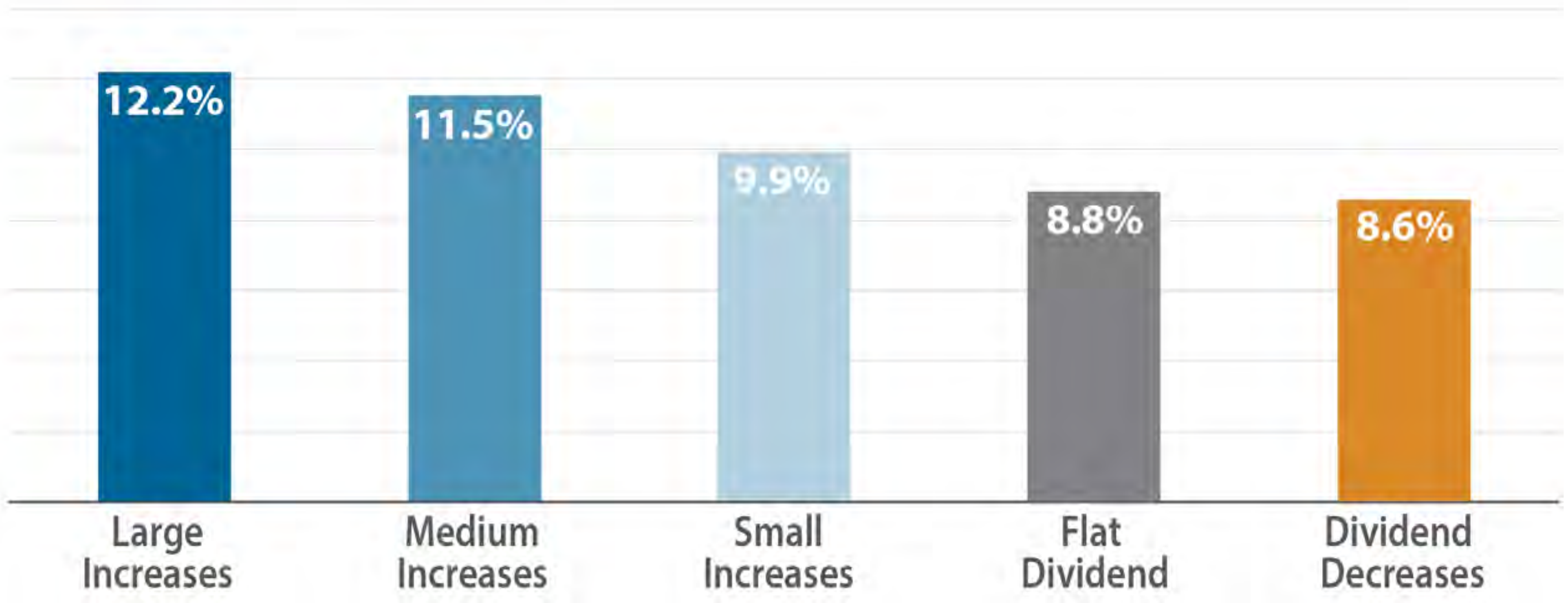
Healthy, growing companies, as characterized by good free cash flow yield, revenue growth and earnings per share growth, are more likely to raise dividends <u>and</u> outperform other dividend payers. Showing that companies announcing big dividend increases also tend to have higher returns in the same year is logically the same as saying a football team that scores a lot of touch-downs in a game also tends to win that game. Not particularly insightful. But what if analyzing dividend behavior raised our odds of predicting total returns in the next year?

Do Larger Dividend Increases Forecast Better Total Returns?

Companies entering a year having announced a large dividend increase in the previous year do indeed have the highest total return in the following year relative to other dividend paying stocks. Medium increasers in the prior year have the second highest average return in the following year. Companies that raise their dividend by any amount in the previous year tend to outperform companies that held their dividend flat or cut it in the previous year.

Bigger Dividend Increases, Better Next-Year Returns

(1998-2023 Annualized)

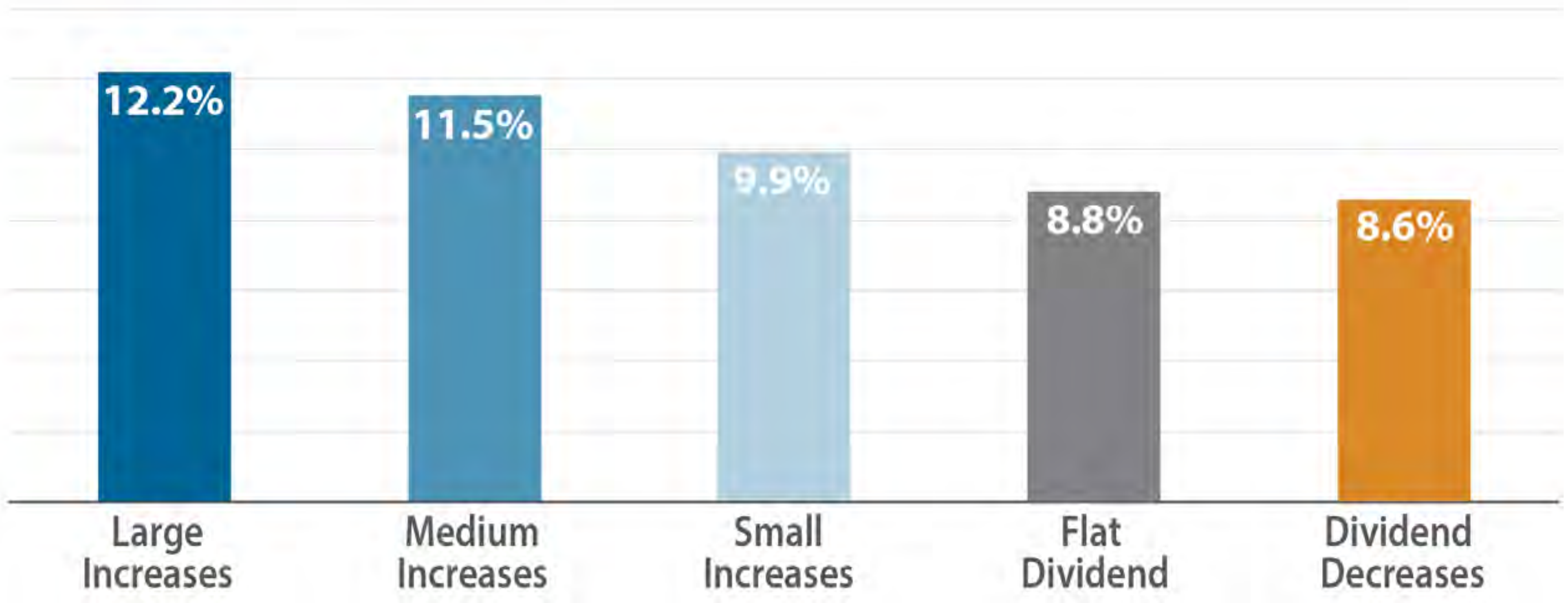


As of December 31, 2023. Sources: Refinitiv; Miller/Howard Research & Analysis. We looked at the average following calendar year total return for Russell 1000 Index dividend payers based on dividend action profile taken the prior year (Large, Medium, Small, Flat, Decrease). We then calculated a compound annual growth rate (CAGR) for each profile. See methodology on page 27.

Note that average returns for companies holding their dividend flat in the previous year are roughly the same as companies that cut the dividend in the trailing year. This is consistent with the idea that the performance penalty for cutters usually anticipates the actual announcement. Whether that is true or not, the historical results suggest that it is just best to stay away from companies that are either likely to cut or have recently cut their dividend.

Bigger Dividend Increases, Better Next-Year Returns

(1998-2023 Annualized)



As of December 31, 2023. Sources: Refinitiv; Miller/Howard Research & Analysis. We looked at the average following calendar year total return for Russell 1000 Index dividend payers based on dividend action profile taken the prior year (Large, Medium, Small, Flat, Decrease). We then calculated a compound annual growth rate (CAGR) for each profile. See methodology on page 27.

We have shown that healthy, growing companies (characterized by high free cash flow yields and good revenue and earnings per share growth) are more likely to announce dividend increases, and are more likely to announce larger increases. In turn, bigger dividend increases are associated with better performance in the same year and in the following year.

At Miller/Howard, our interpretation of these results is that a dividend increase is a signal from management that the future looks bright. It's not just happy talk, but an actual increase in cash payments to shareholders. The fact that larger dividend increases lead, on average, to higher performance strengthens the argument for using dividend increases as a signal.

Miller/Howard portfolio managers are always on the lookout for companies that may raise their dividends. But these results show why sometimes we opt to buy stocks following a large dividend increase. The historical evidence is clear: Dividend increases are likely followed by subsequent hikes *(see the Miller/Howard 3Q 2022 Quarterly Report)*. And as we have shown here, dividend increases tend to lead to subsequent higher total returns on average, with larger dividend increases signaling the best opportunities.

Methodology for Charts:

Analysis based on Russell 1000 Index dividend payers, defined as stocks in the Russell 1000 as of the prior year-end that paid a dividend in the 4th quarter of that prior year. To calculate dividend action in basis points, we subtracted the prior year 4th quarter dividend from the current-year 4th quarter, and then multiplied by 4 to annualize. The result was divided by the stock price at the prior year-end and then multiplied by 10,000 to convert to basis-points (bps). (Semi-annual payers were adjusted accordingly. Specials were excluded from our calculations.)

DISCLOSURE

Miller/Howard Investments Inc. is an independent, research-driven investment boutique with over three decades of experience managing portfolios for major institutions, mutual funds, and individuals in dividend-focused investment strategies. The firm is 100% employee-owned through an Employee Stock Ownership Plan (ESOP).

We continue to evolve and develop strategies that strive to provide investors with various levels of current income and dividend growth. Our objectives are to generate total returns in line with the broad equity market and provide a high and rising stream of income with the lower volatility that an investor might seek from bonds or other income alternatives. With a primary goal of reliable income and long-term returns, coupled with a belief that investors can play an important role in securing a sustainable future, our shareholder advocacy efforts include environmental, social, and governance (ESG) research and/or screening, direct engagement with companies, filing shareholder resolutions, proxy voting, coalition building, and public policy involvement.

The investment strategies described herein are those of Miller/Howard Investments. These materials are being provided for illustrative and informational purposes only. The information contained herein is obtained from multiple sources that are believed to be reliable. However, such information has not been verified, and may be different from the information included in documents and materials created by the sponsor firm in whose investment program a client participates. Some sponsor firms may require that these Miller/Howard Investments materials are preceded or accompanied by investment profiles or other documents or materials prepared by such sponsor firms, which will be provided upon a client's request. For additional information, documents and/or materials, please speak to your Financial Advisor.

DISCLOSURE (continued)

DEFINITIONS

High-Dividend Yield Stocks consists of Decile 7, 8, and 9 of a universe of US dividend paying common stocks with a market capitalization equal to or greater than $1 billion.
Russell 1000 Index® measures the performance of the large-cap segment of the US equity universe. It is a subset of the Russell 3000 Index® and includes approximately 1,000 of the largest securities based on a combination of their market cap and current index membership. The Russell 1000 Index® represents approximately 92% of market capitalization of the US market.

For more information and to request materials: Visit www.mhinvest.com or contact our Internal Sales Desk, email **internals@mhinvest.com** or call (845) 679-9166.
To receive the current ADV Part 2A free of charge email **compliance@mhinvest.com** / Call (845) 679-9166.
Notification to Clients: Contact your Advisor with any material changes to your financial profile that would impact your appropriateness for investment.

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