EPOCH

December 16, 2020

The Enduring Allure and Sustainability of Dividends

The recent economic downturn caused by the COVID-19 pandemic provides another example of the resiliency of dividends. As in the past, they held up better than earnings, with the most severe pressure in specific sectors. They remain an important part of any prudent capital allocation policy. We remain confident in the income generating ability of the Global Equity Shareholder Yield portfolio in part because its underlying dividend coverage ratio and free cash flow growth remain strong. Indeed, dividends among the majority of holdings have continued to grow.

Where will income come from? Pension funds and retirees alike are asking this question as they seek to grow their assets and fund future liabilities. Unorthodox monetary policies have suppressed bond yields and sharply diminished what was once the cornerstone of income generation.

Dividends from equities, however, have remained relatively consistent. Of the three components of equity market returns—dividends, earnings growth (a proxy for free cash flow growth) and valuation multiples—only dividends cannot turn negative; they have been a stabilizing factor for returns every year, going back as far as reliable data exists. Today, equity market yields provide substantially more income than sovereign bond markets in the developed world, where in most cases real yields are negative. If we narrow the equity universe to companies that emphasize paying dividends, yields there are well in excess of those for investment-grade credit. For example, the effective yield for the ICE BofA BBB U.S. Corporate Index was only 2.15% at the end of November.[1]

The sustainability of dividends has been tested through panics, manias, wars and recessions. The COVID-19 pandemic and the recession it triggered provide us with a recent example of their durability.

The reports of my death are greatly exaggerated

Those words were in a cable from Mark Twain to the U.S. press after his obituary was mistakenly published. Similarly, narratives on the "death of dividends" have been proven premature over and over, including in our recent COVID-19 experience.

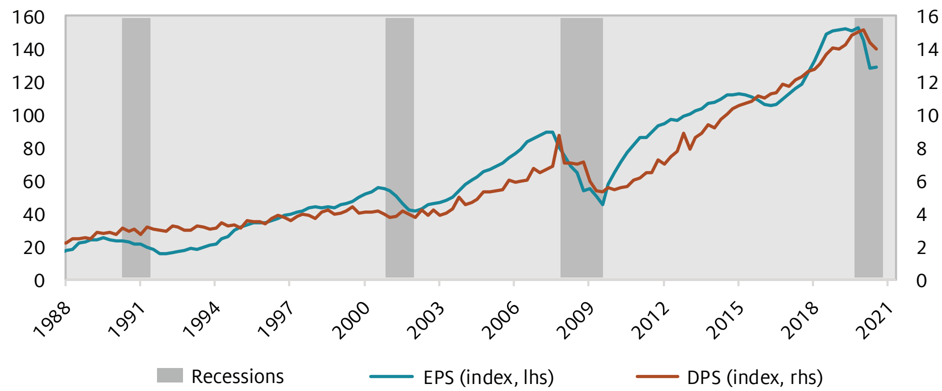
In March 2020, the abrupt decline in revenues, earnings and cash flows raised questions about the capacity for businesses to continue with shareholder distribution practices. There was also heightened political pressure on companies to reduce or restrict shareholder distributions temporarily. In some cases, companies that declared dividends along with annual results earlier in the year canceled or reduced those dividends in response to public pressure—even though in many cases they continue to remain viable businesses with ongoing cash flow that would support dividend payments as announced.

1. Source: Federal Reserve Bank of St. Louis

Despite all this, dividends held up well for several reasons. First, dividends are an important part of any sound capital allocation policy. If a company cannot earn a return that is above its cost of capital on capital reinvestment, then it should return excess cash to the owners of the business through dividends or some other form of shareholder yield.

Second, while companies certainly tighten their wallets in recessions, that does not necessarily put dividends at a high risk. In recessions, dividends tend to be more stable and go down less than earnings in the aggregate, as companies will often maintain payouts during episodes of earnings compression. Share buybacks are more likely to be cut in these environments, often acting as a shock absorber. S&P 500 dividends usually track earnings, but during recessions fall by about half as much. This is illustrated in the following chart.

Dividends decline less than earnings during recessions



Source: Bloomberg, NBER, Epoch Investment Partners

Third, earnings and dividend pressures in economic downturns tend to be concentrated in a few industries. These include energy, financials and consumer discretionary as shown in the following table.

Declines experienced so far during the COVID recession:

	EPS (%)	DPS (%)
SPX	**-28**	**-7.9**
Information Technology	-1.2	0.4
Health Care	-2.3	1.3
Consumer Discretionary	-37.2	-36.1
Communication Services	-13.1	-23.3
Financials	-40	-10.6
Industrials	-36.9	-14.3
Consumer Staples	9.4	2.5
Utilities	-11.2	2.9
Real Estate	-10.5	-5.8
Materials	-28.1	-0.9
Energy	nm	-13

Trailing 12 Months as of 9/30/2020
Source: Bloomberg, Epoch Investment Partners

Furthermore, these pressures vary widely among companies within each sector, highlighting a benefit of active management in seeking to avoid companies where the dividend could be at risk. The positioning of the Epoch Global Equity Shareholder Yield strategy in energy, financials, consumer discretionary, consumer staples and healthcare is summarized below:

Sector and stock examples[2]

ENERGY		
Sector comments	**Portfolio Stats as of 9/30**	**Stock Example**
• Our exposure to the energy sector has decreased since the beginning of the year and is currently a relatively small weight in the portfolio • Our holdings are diversified across a mix of subsectors including large global integrated, midstream, and integrated midstream/downstream companies • Highly cyclical sector and cash flow generation fluctuates in sync with the cycle • In a strong commodity price environment, companies generate free cash flows that more than cover their dividends. Excess cash is often deployed for share buybacks and/or debt reductions. • In a downcycle, such as the current one, the strength of balance sheet determines each company's ability to support its dividend • Key balance sheet metrics such as net debt leverage and net debt-to-EBITDA are taken into consideration. We also evaluate capex flexibility of each company and their ability to reduce operating costs to preserve cash. – As part of our fundamental analysis, we have developed a sensitivity analysis that we have been applying to the portfolio holdings since the last oil crisis (2014-2016). The analysis not only assesses dividend safety at low oil prices but also evaluates potential for cash return via share buybacks and/or debt reductions at high oil prices. – The companies we own possess strong balance sheets and should be able to withstand the current commodity price cycle and maintain their dividends	• Dividend coverage ratio for the sector: 1.0 • Forward free cash flow growth (3 years): ~4%	**TOTAL SE** *Global Integrated Energy Company* • Cash flow generation from an integrated model that includes exploration & production, refining & chemicals, and marketing & services • High-quality low-cost hydrocarbon assets. Low breakeven at <$25 per barrel • Growing energy production from LNG and renewables. Positioned well in energy transition with a goal of net-zero by 2050 • Disciplined and flexible in capex. Accelerating cost reduction in all segments • Capital allocation policy with a priority on the dividend that is supported at $40 Brent, followed by debt reduction and share buybacks • Strong balance sheet with a net debt leverage of 22% (as of 9/30/2020) and credit ratings of Aa3/A+/AA- at Moody's/S&P's/Fitch, respectively

Source: Epoch Investment Partners

Continued

2. *Securities highlighted or discussed in this section have been selected to illustrate our investment approach and are not intended to represent the strategies performance or be an indicator for how the strategy has performed or may perform in the future. Each security discussed in this section has been selected solely for this purpose and has not been selected on the basis of performance or any performance-related criteria.*

FINANCIALS

Sector comments	Portfolio Stats as of 9/30	Stock Example
• Our exposure to the financials sector is broadly diversified globally and encompasses insurance companies, banks, asset managers and exchange operators – Insurance: holdings are diversified businesses that generate solid top-line growth, exercise good expense controls and possess quality assets. Companies we own have strong regulatory capital positions, growing free cash flow and sound capital allocation policies. Exposure is diversified across holdings in the U.S., Europe and Japan – Banks: holdings have diversified revenue sources and supplement net interest income with non-interest income across several sources. These companies consistently generate pre-tax, pre-provision profit and deliver an attractive ROE while maintaining strong regulatory capital positions – Asset managers: market leaders that generate strong, recurring cash flows from management fees. Cash flow growth is driven by organic growth through net inflows. Holdings also possess capital light business models which generate strong free-cash flow and high operating margins – Exchange operators: industry leaders that generate cash flow through fees earned for executing trades as well as providing services related to market-making activities. Companies in the portfolio have diversified product portfolios across physical securities as well as equity, FX, and commodity derivative securities which allows for consistent earnings and cash flow. Growth is also achieved through international expansion	• Dividend coverage ratio for the sector: 2.1 • Forward free cash flow growth (3 years): >3%	**ALLIANZ** *Multinational financial services company* • Diversified financial services company operating globally and engaged in insurance and asset management (including PIMCO) • As of 12/31/19 company managed €2.3 trillion • 2019 revenue: €142 billion • Consistently generates high ROE; above 11% in recent years. • Solvency II ratio 212% as of 12/31/19 • Cash flow drivers include trend growth in demand for insurance in targeted markets, growth in third-party AUM, and product innovation • Returns capital to shareholders via an attractive and consistently growing dividend: – Dividend payout is 50% of earnings and is expected to grow each year – Annual dividend has grown at a high-single-digit pace

Source: Epoch Investment Partners

CONSUMER STAPLES

Sector comments	Portfolio Stats as of 9/30	Stock Example
• Companies owned in the portfolio are diversified across subsectors and have the following characteristics: – Generate mid-single-digit cash-flow growth and disciplined about cost controls – Strong brands and market share positions (#1 or #2 player) – Low-mid single digit sales growth – Pay modest to average dividend yields (~3% on avg), with tobacco being the highest – Dividends are typically covered by free cash flow by 1.5x	• Dividend coverage ratio for the sector: 1.7 • Forward free cash flow growth (3 years): >7%	**KIMBERLY-CLARK** *Global health and hygiene company* • Strong brands, market position, cost controls, supply chain efficiencies • Accelerating growth in the emerging markets • Low-single-digit sales growth in core categories and mid-single digit earnings growth • Effective capital allocation - dividends grow in line with earnings • Excess cash flow goes to share buybacks which were reinstated in July • Long history of paying and growing dividends – Returned $12.5b in dividends over past 10 years, with ~$10b in buybacks – Dividend is ~1.5x covered by free cash flow – Increased the dividend earlier this year, declared next dividend paid in June

Source: Epoch Investment Partners

Continued

CONSUMER DISCRETIONARY

<table>
<tr><th>Sector comments</th><th>Portfolio Stats as of 9/30</th><th>Stock Example</th></tr>
<tr><td>The sector is very broadly diversified across several subsectors and industries. The vast majority of the portfolio's current exposure is in consumer durables & apparel, consumer services, and retailing.

Companies we own share the below characteristics:

• Cash flows sustained by strong business models, attractive industry structures and relatively resilient demand for their market leading brands
• Dividends that are covered by free cash flow at ~2x
• Generate mid-single digit or greater cash flow growth per year
• Payout ~3-5% shareholder yield with 2-3% in dividends and 1-2% in share repurchases and debt reduction during normal times
• Most have investment-grade balance sheets with limited leverage and good liquidity</td><td>• Dividend coverage ratio for the sector: 2.7%
• Forward free cash flow growth (3 years): ~6%</td><td>TARGET CORPORATION
Leading operator of primarily large format general merchandise stores in the U.S.
• Cash flows sustained by:
– Customer loyalty to Target's exclusive owned and national brands
– Extensive omnichannel offering and superior customer service
– Value focus and operational efficiency
– Ability to manage working capital and capex during downturns
• Key cash flow growth driver is comparable store sales growth across in-store and digital distribution channels as the company takes market share from weaker retailers
• Additional cash flow growth drivers include square footage growth, working capital improvements and stable margins
• Potential to generate mid-high single digit normalized cash flow growth
• Free cash flow coverage of the dividend at ~5x over the last year v. 3x historically
• Capital allocation policies:
– Prioritize reinvestment through internal projects including remodeling stores, transforming its distribution centers and launching small store formats
– Committed to growing the dividend – increased its DPS in June by 3% to $0.68 annually
Past 10 years: cumulative free cash flow of $33B returned through mostly dividends and share repurchases along with debt reduction</td></tr>
</table>

Source: Epoch Investment Partners

HEALTH CARE

<table>
<tr><th>Sector comments</th><th>Portfolio Stats as of 9/30</th><th>Stock Example</th></tr>
<tr><td>• Favor companies that are driving growth through unit volume rather than price increases
• Pharmaceuticals account ~80% of our holdings which have robust and relatively defensive free cash flow, strong balance sheets and attractive shareholder return policies
– Holdings have been resilient in terms of supply & demand for drugs
– Cash flows sustained by brand equity, drug efficacy, multi-year patent protection, product innovation, business diversification & scale-based cost advantages
– Cash flows can grow at a mid-high single digit rate over the next few years driven by solid revenue growth and operating leverage on fixed costs
– Majority of our pharmaceutical holdings reiterated their guidance for 2020</td><td>• Dividend coverage ratio for the sector: 2.0%
• Forward free cash flow growth (3 years): ~10%</td><td>JOHNSON & JOHNSON
World's largest health care company
• Annual sales of > $80 billion are growing and geographically balanced
• The ~3% dividend yield is well covered by free cash flow at 2x
• Generated ~$20B of free cash flow and paid ~$10B in dividends over the past twelve months
• 6.3% dividend increase in April
• High-single-digit cash-flow growth driven by pharma business expected to account for ~75% of the forecasted revenue growth over the next 5 years</td></tr>
</table>

Source: Epoch Investment Partners

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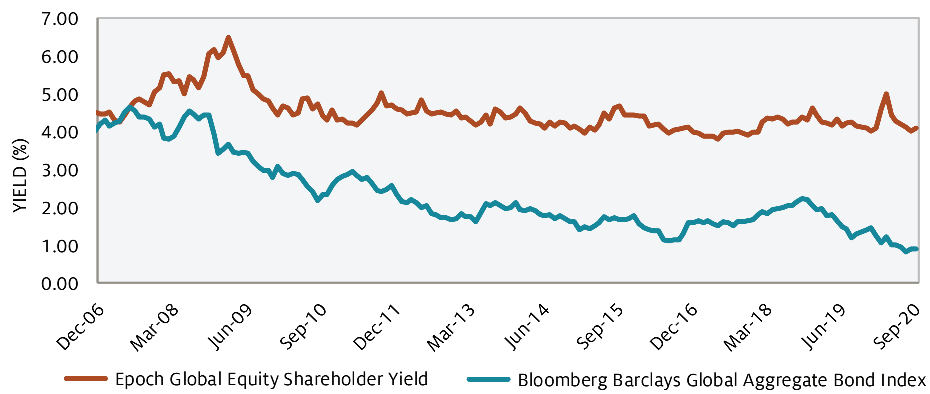
Putting it all together

We have confidence in the resilience of dividends in the Global Equity Shareholder Yield strategy. Free cash flow coverage of the dividend is one key metric to help determine whether a company can sustain its dividend. While this metric will vary by sector, we like to see at least 1x and ideally 1.5x or greater at the portfolio level. As of September 30, the dividend coverage ratio for the portfolio was 1.8*.

Another source of confidence in the sustainability of the dividends is based on the current trailing and forward free cash flow growth rates of the portfolio. As of September 30, the trailing free-cash-flow growth of the portfolio was 9.8%* for the past five years and 6.1%* for the past three years. The dividend yield of the portfolio was 4.1%.

The Global Equity Shareholder Yield strategy has historically achieved a high level of income by assembling a diversified portfolio of high-quality companies that generate sustainable free cash flow and consistently return excess cash to shareholders in the form of dividends. It is diversified not only across sectors and countries but also by contributors to dividend yield and growth. The holdings tend to be global champions with dominant industry positions and the ability to grow free cash flow in both challenging and strong market environments. We can see in the chart below that the portfolio's income has held up remarkably well, especially when compared to bonds.



Sources: Bloomberg, FactSet. As of September 30, 2020.
The data shown for Global Equity Shareholder Yield is of a representative account and such data may vary for each client in the strategy due to market conditions, client guidelines and diversity of portfolio holdings.

**Source: Epoch Investment Partners*

The team has been tracking the number of companies that increase their dividends since 2008. From 2008-2019 we have seen a range of 62-88 companies increase their dividends on an annual basis for an average of 77 per year. Data is below:

Number of portfolio companies that increased their dividends:

2008	2009	2010	2011	2012
62	69	72	88	82
2013	**2014**	**2015**	**2016**	**2017**
73	79	83	71	79
2018	**2019**	**YTD 2020 as of 9/30**		
84	85	54		

Several companies increased their dividends more than once in each year.

Source: Epoch Investment Partners, Inc. The data shown above is for a representative account. Such data may vary for each client in the strategy due to market conditions, client guidelines and diversity of portfolio holdings. The data is unaudited and may change at any time. The data is supplemental to the composite presentation, is shown for informational purposes only, and is not indicative of future portfolio characteristics or returns.

It has been a challenging period on many fronts. A majority of our portfolio holdings, however, have maintained cash on their balance sheets and continued to generate the cash flow necessary to sustain and grow their dividends. And they are unlikely to abandon sound capital allocation policies as they manage through the effect of the pandemic on their businesses.

- 54 companies owned in our portfolio have increased their dividends YTD through 9/30
- Several companies have reinstated their guidance or reiterated their commitment to the dividend
- Some companies have resumed their buyback programs (Kimberly Clark, MetLife) and we expect more to do so in Q4 and 2021.

In closing, the Shareholder Yield team remains focused on what we think we can do consistently: identify companies with a track record of growing free cash flow, strong balance sheets and good capital allocation practices that are committed to paying a dividend.