

MARCH 15, 2021

On the Radar

FAQS ON THE MARKETS AND ECONOMY

What is CNR's outlook for dividend stocks?

In our view, dividend and income equities offer some of the greatest remaining value for investors. Looking out over the next few years, we see continued recovery in our dividend stocks and have a high level of confidence in our 6-10% expected annual returns assumption.

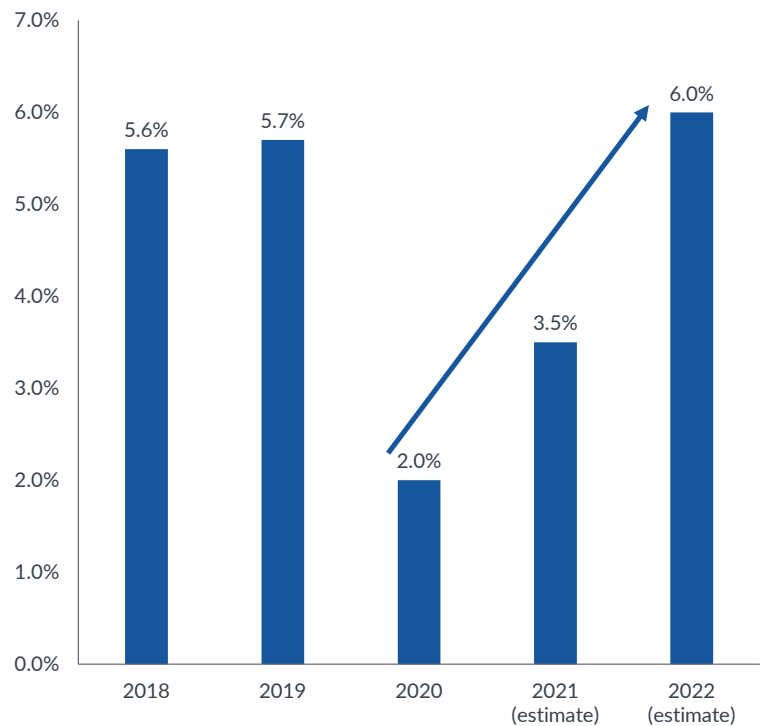
Building blocks of our expected return include, most importantly, the dividend yield, followed by growth in the yield, and additionally, some continued equity appreciation.

A post-COVID environment helped along with massive fiscal and monetary stimulus should provide a solid tailwind for dividend equities. In addition, low interest rates should continue to attract income investors.

The main factor we are watching out for is concerns over higher interest rates driven by some combination of strong economic growth and worries about inflation. Accordingly, we have been pivoting from a position of defensiveness to one of increasing dividend growth.

Dividend growth in our invested companies is expected to increase to 6% in 2022 after improvement to 3.5% in 2021 (chart). This type of strong dividend growth will help fuel our expected total returns while helping to insulate us from potentially higher interest rates (or even fears of higher rates).

Dividend Growth of the HDI stocks
(actual and CNR research estimates)



Source: FactSet, CNR Research.

KEY QUESTIONS

Is the labor market improving?

Where is all the cash the Treasury is holding at the Fed going?

Are rising interest rates a concern for equity investors?

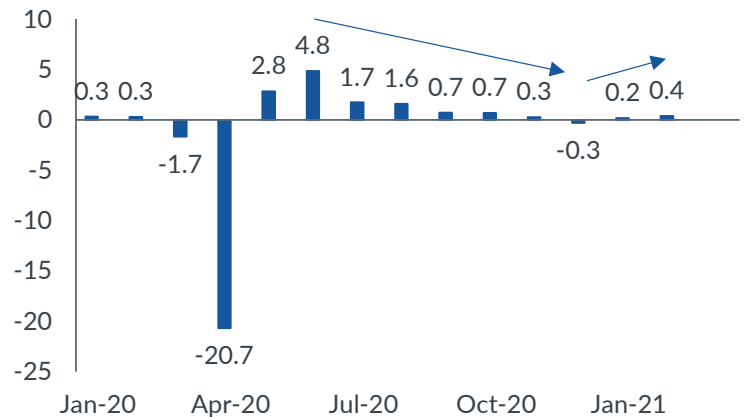
Is the labor market improving?

Payrolls are rebounding following the winter lull. The past two months have been on an uptrend, reversing the negative path in payroll growth of the second half of last year (chart).

The reopening of regional economies, especially in California, contributed heavily to the gains in January and February. What makes the February report even more impressive is this increase happened during some severe weather in most of the country. Imagine what the improvement would have been if the weather was better. The number of people who could not work last month due to weather was 897,000, about 600,000 more than usual.

The unemployment rate fell to 6.2% from 6.3%. It has experienced a sharp decline from last April's peak of 14.2%.

Nonfarm Payrolls ('000)
millions, monthly change



Source: Bureau of Labor Statistics as of February 2021.

Where is all the cash the Treasury is holding at the Fed going?

The Treasury Department has more than \$1 trillion on deposit at the Fed, which is more than twice their normal balance. The amount is high because the government borrowed money for pandemic relief but has not spent it all.

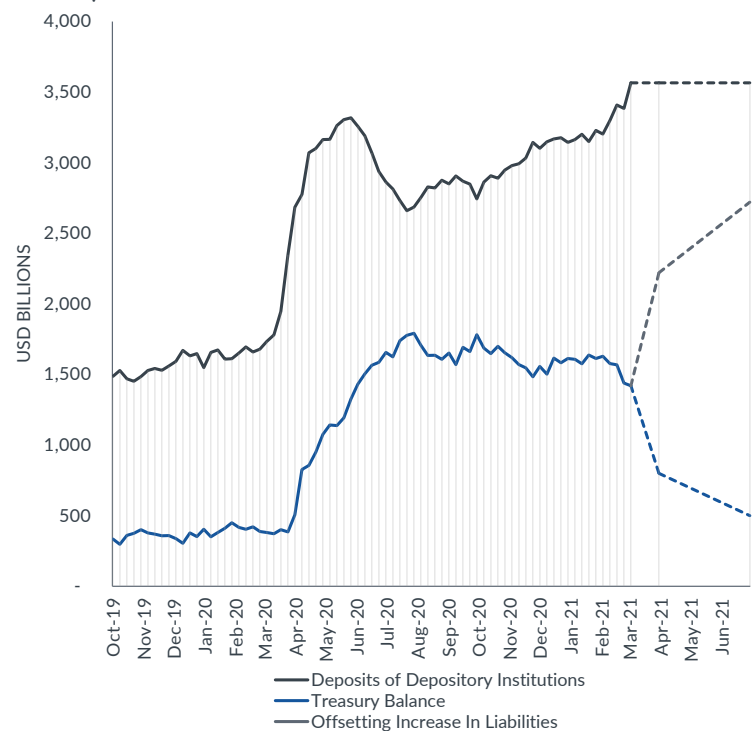
The Treasury now plans to dramatically reduce the size of the account as the government spends money on additional relief and other expenditures.

As the money moves from government accounts to individual accounts, it will put downward pressure on short-term interest rates, which are already at a very low level.

The Fed has a couple of monetary tools up its sleeve that will help prevent interest rates from falling below zero, such as offering higher interest rates on excess bank reserves.

Short rates going below zero poses a problem for money market funds, a problem the Fed surely will want to avoid.

Selected Liabilities of the Federal Reserve (Projected After March)



Source: Federal Reserve Bank.

Are rising interest rates a concern for equity investors?

Equity markets have consolidated recently amid concerns that rising bond yields may begin to weigh on stock returns.

How equity markets react during periods of rising interest rates has depended heavily on why interest rates are rising and the state of the economy, with inflation being a key factor. Rising rates during periods of high inflation in particular have generally been corralled with lower stock returns.

Today, higher rates are being driven in large part by an improving growth outlook that should also support corporate profits. At the same time, inflation, while normalizing, remains low, and we expect a continuation of the deflationary forces that existed prior to the pandemic to keep price pressures ahead more gradual than feared.

The S&P 500 has historically done well in this type of environment, although higher volatility is likely in coming months (see table).

For equity investors, it's important to remember that rising interest rates are starting from very low levels. In fact, despite recent increases, the current 10-year Treasury yield is still below its 60-year pre-pandemic low.

At some point, higher borrowing costs will become an increasing burden for business, consumers and governments, but at current or even higher levels, we believe interest rates remain low enough to support a robust economic recovery and higher equity returns.

Start Date	End Date	Length (Months)	Change in 10Y Treasury Yield	S&P 500 Gain/Loss
Dec-62	Aug-66	45	1.7%	18.3%
Mar-67	Dec-69	34	3.6%	1.3%
Mar-71	Sep-75	55	3.2%	-18.1%
Dec-76	Sep-81	58	9.0%	8.7%
May-83	May-84	13	3.9%	-7.9%
Aug-86	Oct-87	14	3.3%	11.8%
Oct-93	Nov-94	13	2.9%	-1.4%
Jan-96	Jul-96	6	1.5%	6.7%
Oct-98	Jan-00	16	2.6%	45.8%
Jun-03	Jun-06	37	2.1%	26.0%
Dec-08	Apr-10	15	1.9%	33.3%
Jul-12	Dec-13	18	1.6%	38.1%
Jul-16	Oct-18	27	1.9%	35.5%
Average		27	3.0%	15.2%
Median		18	2.6%	11.8%
% Positive				76.9%
% Negative				23.1%

Source: FactSet.

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Index Definitions

S&P 500 Index (S&P500) is a stock market index that tracks the 500 most widely held stocks on the New York Stock Exchange or NASDAQ. It seeks to represent the entire stock market by reflecting the risk and return of all large-cap companies.