

Client Commentary | December 18, 2024

Market Commentary

Investing Insights

Will 2025 be a Comeback Year for Dividend Stocks?

As the S&P 500 Index rallies to new heights, one category has notably not been keeping pace: dividend-paying stocks.

Year-to-date, the S&P 500 index is up approximately +27% (as I write), while the S&P 500 Dividend Aristocrats Index—which is made up of 66 companies that have continuously raised their dividends over two decades—is up about 8%. ¹

I think this gap could shrink meaningfully in 2025.

One reason is valuations. As I write, the S&P 500 index is trading at roughly 23x forward earnings, but a big driver of recent returns—the Technology sector—is trading at over 30x forward earnings. Meanwhile, the Health Care, Financials, and Utilities sectors, where we tend to find more value companies that pay dividends, are all trading at roughly 18x forward earnings. Investors may look kindly at sectors and companies that trade at a discount to the broad market, particularly at a time when some are starting to worry about overheating.

Another reason is earnings. 2023 and 2024 were both years when mega-cap Technology companies, and in particular the “Magnificent Seven,” were running ahead of all other sectors in annual earnings growth. The Magnificent Seven generated 35% earnings growth in 2023 and 29% (estimated) in 2024, compared to the rest of the S&P 500’s -4% and 2% (estimated) earnings growth over the same period. I expect this dynamic to shift considerably in the new year, with the Magnificent Seven producing 19% earnings growth in 2025 compared to the rest of the S&P 500’s 13% earnings growth.

As earnings growth broadens beyond Technology, I think investors could rotate to areas of the market where earnings growth is accelerating versus decelerating. We saw early signs of this rotation in Q3, in my view, as value outperformed growth and sectors outside of Technology were the ones driving strong gains for the quarter. I think this trend could continue in 2025.

A third reason I think dividend-paying stocks could make a comeback in 2025 is that investors are increasingly demanding cash. The S&P 500's dividend yield recently hit a 20-year low when it dropped below 1.19%, compared to the long-term historical average of 4.3%. In an environment where interest rates have recovered on risk-free securities like Treasuries, companies are realizing that there's increased competition for yield, and many are responding by raising dividends or initiating them for the first time. Indeed, some very notable technology behemoths shifted to paying dividends for the first time in 2024, which I view as a signal to markets that they're positioning as value plays in a high-growth sector.

A final reason I think dividend stocks could experience a turnaround in 2025 is volatility. The last time dividend stocks outperformed the broad market was in 2022 when recession fears pulled investors towards utilities, consumer goods, and other sectors where value stocks and 'quality' earnings tend to reside. I'm not suggesting that recession fears will necessarily return in 2025, or that a bear market is in the offing. But powerful rallies like what we've seen in 2023 and 2024—which have essentially helped drive dividend stocks' lag—tend to invite greater levels of volatility in the future, especially if lofty growth forecasts show any signs of not being met. As the new administration aggressively pursues its new economic agenda, there could be speed bumps and instances of uncertainty. The short-term volatility that could follow could benefit dividend-paying stocks, in my view, which would be viewed as stable and steady.

BOTTOM LINE FOR INVESTORS

A stock's price will go up and down over time, but a dividend payment is always positive once it's made. What's more, dividend payments are generally more predictable if an investor scrutinizes a company's dividend payment history and earnings from quarter to quarter (which Zacks Investment Management does).

When we invest in dividend-paying stocks, we look for high-quality companies paying dividends that they can sustain and also grow over time. I see a dividend-stock strategy as a middle ground between a fixed-income strategy and a high-growth strategy, part of a diversified approach that can serve to reduce overall portfolio volatility. In this sense, a well-constructed dividend strategy is not losing its appeal—in fact, it may gain more appeal in the new year.

¹ Wall Street Journal. December 7, 2024. https://www.wsj.com/finance/stocks/dividend-stocks-2025-payoff-1d0a4521?mod=djemMoneyBeat_us

**STEADY INVESTOR
WEEK**

- **CEOs are gaining confidence for the year ahead**
- **The housing affordability crisis spreads worldwide**
- **China's economic growth slows**

U.S. CEOs are Feeling Optimistic

As the CEOs of America's companies—big and small—look ahead to 2025, they're feeling optimistic about their growth prospects. While many have cited experiencing stronger-than-expected sales and earnings in 2024, a key factor driving year-end optimism is the anticipation of lower corporate taxes and fewer regulations. According to a survey of more than 300 CEOs of publicly traded companies, 77% of top executives said they anticipate the global economy to expand in the first half of 2025. Compare that figure with the 45% who anticipated global economic expansion in 2024, and the even lower number who expected growth. We know now that the economy expanded in both years, but it's also fair to say that growth across sectors, industries, and regions was largely uneven. Some sectors like Technology flourished, while others like Energy lagged. CEOs are also expecting deal activity in the new year, with fewer regulatory hurdles to M&A and more access to capital in the coming quarters. 80% of respondents saw M&A picking up in 2025, perhaps rising to record levels seen in 2021.¹

Housing Market Woes are Not Confined to the U.S.

Housing affordability is becoming a growing issue worldwide. According to the International Monetary Fund, inflation-adjusted home prices rose 32% in the decade through 2021, which largely precedes the pandemic-era price surge fueled by low interest rates and a rapid transition to hybrid and remote work. Rising interest rates in response to inflation have severely impacted housing affordability, but limited supply has arguably been the bigger driver. According to an analysis from the Bank for International Settlements, countries with the lowest levels of home building have seen the largest price increases over the past decade. There are several factors that have influenced the pace of homebuilding. Regulations are one, where red tape and permitting make building new units increasingly challenging and time-consuming. National governments including the U.K., Canada, Germany, and South Korea have attempted to loosen rules to bolster construction, but the recurring issue is that state and local regulations neutralize those efforts because they are designed to protect local homeowners. The result is that homes are less affordable now than they were before the 2008 Global Financial Crisis, even as incomes have generally gone up. Younger generations are the ones largely encountering these barriers—across many countries, the average age of first-time home buyers has gone up dramatically in the past few years.²

China's Economy Continues to Falter

2024 was not a flagship year for China's growth. While economists still believe China can achieve its growth target of roughly 5%, there is growing skepticism that the economy is on strong enough

footing to accelerate into the new year. Retail sales decelerated sharply in November, rising just 3% year-over-year compared to October's 4.8% gain. Investments in fixed assets like buildings and equipment also slowed, with property investment plummeting by -10.4% in 2024's January to November period compared to 2023. Industrial production was a bright spot, rising 5.4% year-over-year, but that was tied to direct investment from China's government. In the coming year, China may also have to reckon with a sharp increase in tariffs, which could hamstring its export economy at a vulnerable time. For its part, the Chinese government is telegraphing to markets that more help is on the way, as they pledge additional government borrowing and lower interest rates.³

¹ Wall Street Journal. December 16, 2024. https://www.wsj.com/business/ceos-are-feeling-a-lot-more-upbeat-about-the-new-year-9fca7212?mod=djemMoneyBeat_us

² Wall Street Journal. December 16, 2024. https://www.wsj.com/economy/housing/housing-affordability-crisis-europe-global-3e0d969a?mod=djemMoneyBeat_us

³ Wall Street Journal. December 14, 2024. https://www.wsj.com/world/china/data-paint-mixed-picture-for-chinese-economy-f5b3aeb8?mod=djemMoneyBeat_us

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The S&P 500 Index is a well-known, unmanaged index of the prices of 500 large-company common stocks, mainly blue-chip stocks, selected by Standard & Poor's. The S&P 500 Index assumes reinvestment of dividends but does not reflect advisory fees. The volatility of the benchmark may be materially different from the individual performance obtained by a specific investor. An investor cannot invest directly in an index.

The Russell 1000 Growth Index is a well-known, unmanaged index of the prices of 1000 large-company growth common stocks selected by Russell. The Russell 1000 Growth Index assumes reinvestment of dividends but does not reflect advisory fees. An investor cannot invest directly in an index. The volatility of the benchmark may be materially different from the individual performance obtained by a specific investor.

Nasdaq Composite Index is the market capitalization-weighted index of over 3,300 common equities listed on the Nasdaq stock exchange. The types of securities in the index include American depository receipts, common stocks, real estate investment trusts (REITs) and tracking stocks, as well as limited partnership interests. The index includes all Nasdaq-listed stocks that are not derivatives, preferred shares, funds, exchange-traded funds (ETFs) or debenture securities. An investor cannot invest directly in an index. The volatility of the benchmark may be materially different from the individual performance obtained by a specific investor.

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