

EQUITY INCOME INVESTING IN 2025: WHY DIVIDENDS ARE SET TO SHINE

We describe the enduring appeal of high-quality companies with reliable dividends.

INVESTMENT VIEWS

FROM OUR PARTNERS AT
NEWTON INVESTMENT MANAGEMENT

Newton, a BNY affiliate, is an active equity manager across a range of strategies.

KEY POINTS

1 We continue to see the potential for volatility, with rising inflationary pressures, geopolitical risks and monetary policy acting as key factors shaping market dynamics.

2 Generally, companies that pay and grow dividends tend to be more resilient in downturns as investors seek stability in uncertain times.

3 As the market evolves, we will remain focused on striving to deliver steady income and growth potential, ensuring we are prepared for what the year ahead may bring.

2024 has been characterized by pronounced volatility, affecting everything from interest-rate fluctuations and inflation expectations to the economic implications of artificial intelligence and shifting political landscapes. Heading into 2025, much of this uncertainty is likely to persist. With inflation remaining above pre-pandemic levels and geopolitical tensions continuing, the market faces continued dislocation. Amid these challenges, Newton remains steadfast in our balanced, risk-adjusted and dividend-focused approach, which looks to deliver competitive returns in volatile environments.

Inflation Unfolding

From a global perspective, the current environment is characterized by disinflationary growth, with inflation rates decreasing from the peak levels of 2022. However, there are concerns that inflation could pick up again in 2025, primarily due to President Trump's anticipated tariffs and their impact on the prices of goods and services. Newton anticipates that inflation should remain above consensus expectations, gradually rising from mid-2025 and ending the year between 2.5% and 3%.

The Second Act: A Stage Set for Uncertainty

President Trump's second term introduces additional ambiguity surrounding the future of interest-rate adjustments. While Jerome Powell remains Federal Reserve (Fed) Chair until 2026, President Trump's proposed policies could complicate interest-rate positioning for the central bank. We

believe the Fed will largely overlook the increase in inflation, particularly if there is no substantial response from wages, indicating no second-round effects.

The market has already begun pricing in fewer interest-rate cuts as pro-growth policies could slow the rate-cutting process. We foresee the Fed's cutting cycle in 2025 to be shallow and potentially paused early, with the federal funds rate likely settling around 3.75-4% by year end, aligning with current market pricing. We expect 10-year yields to trade near 4.5%, above the consensus forecast of 4.1%.

The risks to inflation and yields hinge on economic growth trends. If disinflationary growth deteriorates into deflation, we could see commodity prices fall, especially oil, which would likely push yields lower. Conversely, if the Trump administration pressures the Fed for aggressive easing and increases fiscal spending, bond markets may react negatively, causing yield-curve steepening and market volatility. Both scenarios are plausible in 2025.¹

¹ Source: BNY Investment Institute, December 2024.

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Heading into the coming year, we remain vigilant, understanding that continued volatility could lead to periods of heightened uncertainty, as well as opportunities for well-positioned investment strategies. We acknowledge the higher probability that inflation could persist, but we are prepared to manage these risks through our portfolio construction and broad risk controls.

As inflationary pressures and market volatility are expected to persist into 2025, a dividend-focused approach may prove valuable. In our view, dividends can

offer an essential hedge against inflation and the potential for a more reliable income stream, marking them as a key component of our strategy in uncertain times.

The Changing Appeal of Dividend Yield

The demand of dividend-paying stocks is influenced by broad market investor sentiment. For much of 2024, dividend-paying stocks underperformed as investors favored high-growth

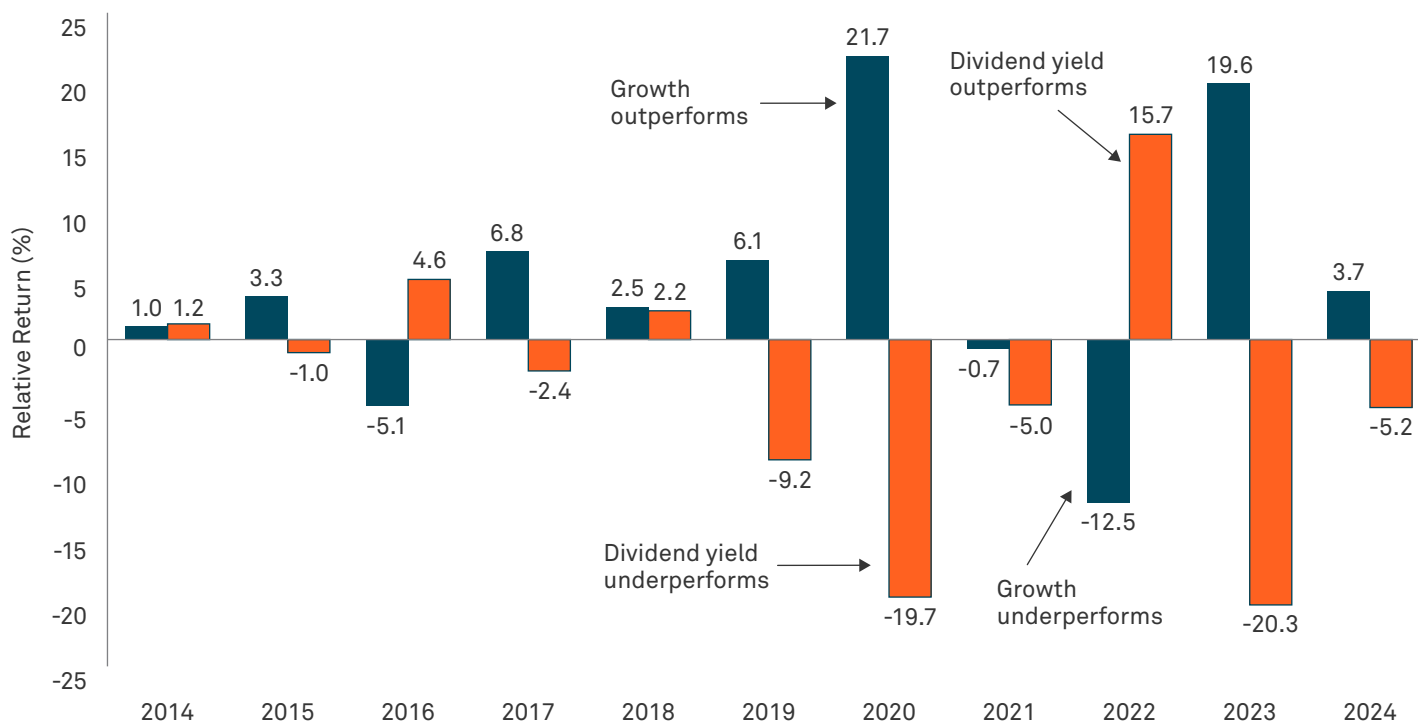
companies. The shift from risk-on to risk-off and back to risk-on exemplifies the market's current uncertainty.

As demonstrated in the chart below, the preference for dividend yield tends to undergo fluctuations over time. During phases when dividend-paying stocks lose their appeal, often due to a heightened focus on growth stocks, carefully designed risk controls can help investors adeptly navigate the shifting market sentiments.

SHIFTING INVESTOR PREFERENCE BETWEEN GROWTH AND DIVIDEND YIELD: MSCI RELATIVE RETURNS

December 31, 2014–September 30, 2024

■ MSCI US Growth, relative ■ MSCI US Dividend Yield, relative



Source: MSCI, as of September 30, 2024. **Past performance is no guarantee of future results.** Chart is for illustrative purposes only. The MSCI USA Growth Index captures large and mid cap securities exhibiting overall growth style characteristics in the US. The MSCI USA High Dividend Yield Index is based on the MSCI USA Index, its parent index, and includes large and mid cap stocks. The index is designed to reflect the performance of equities in the parent index (excluding REITs) with higher dividend income and quality characteristics than average dividend yields that are both sustainable and persistent. The index also applies quality screens to omit stocks with potentially deteriorating fundamentals that could force them to cut or reduce dividends. Investors cannot invest directly in any index.

Why Dividends Are Set to Shine

The opportunity set within the S&P 500® has grown as more high-growth sectors, particularly information technology, health care and industrials, have seen an increased adoption of dividend payments. As of September 2024, around 80% of S&P 500 companies pay dividends, with 24% of those in the technology sector, up from 13% a decade ago. This shift highlights that growth and income can go hand in hand.²

We feel that dividend-focused investing is particularly compelling in today's market. Companies that pay and grow dividends tend to be more resilient in downturns as investors seek stability in uncertain times. These companies also have the ability to increase payouts in line with or above inflation, making them an appealing choice for income-focused investors. In a low interest-rate environment, where bond yields are less attractive, dividend paying stocks have the potential to become even more compelling. With inflation remaining

above pre-pandemic levels and potentially moving higher, these stocks can be an effective hedge, further enhancing their appeal. Dividends remain an important tool for managing volatility while seeking to provide steady income and a potential hedge against inflation.

Equities hold a unique advantage in their ability to adjust for inflation, unlike bond yields which remain static. Despite the current dividend yield standing at approximately 2.1%, and bond yields at around 4.2%, the S&P 500 has returned 28.1% year to date (through November 30, 2024, per FactSet), far surpassing the bond yield. This stark difference underscores the potential of equities not only to keep pace with inflation but also to outstrip it, thereby preserving and enhancing the investor's buying power. In contrast, bond holders may see their purchasing power eroded in an inflationary environment, making dividend-paying equities a compelling alternative for those seeking both income and growth.

Looking Ahead to 2025

As we look to the year ahead, we continue to see the potential for volatility, with rising inflationary pressures, geopolitical risks and monetary policy as key factors shaping market dynamics. The ever-shifting developments surrounding these factors could drive uncertainty, but they may also create opportunities for investors focused on quality companies with reliable dividends. We remain committed to identifying these companies, maintaining a disciplined, dividend-focused approach as we traverse the uncertainty that lies ahead. As the market continues to evolve, we will remain focused striving to deliver steady income and growth potential, ensuring we are prepared for what the year ahead may bring.

² Source, Franklin Templeton, Four Reasons Dividends Matter Now, November 12, 2024.

Disinflation is the temporary slowing of the pace of inflation. **Deflation** is the general decline in prices for goods and services. Deflation occurs when the inflation rate falls below 0%.

There is no guarantee that **dividend-paying companies** will continue to pay, or increase, their dividend. High-dividend stocks may not experience the same capital appreciation as non-dividend paying stocks during periods of high growth for equities. **Equities** are subject to market, market sector, market liquidity, issuer, and investment style risks, to varying degrees. **Bonds** are subject to interest rate, credit, liquidity, call and market risks, to varying degrees. Generally, all other factors being equal, bond prices are inversely related to interest-rate changes and rate increases can cause price declines. **Asset allocation and diversification** cannot ensure a profit or protect against loss.

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The S&P 500® Index is widely regarded as the best single gauge of large-cap US equities. The index includes 500 leading companies and captures approximately 80% coverage of available market capitalization. Investors cannot invest directly in any index.

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