March 2020
Income portfolios addendum

In the main portfolio review, I comment that many businesses in the most affected sectors such as tourism and hospitality, aviation and retail will have to cut or suspend dividend payments entirely for a period to preserve their cash resources and the viability of their businesses. Companies that receive government assistance to stay afloat, will find it particularly difficult to justify maintaining their dividend payments to shareholders. Even those companies that are benefitting somewhat (food, logistics, pharma for example) and have ample financial capacity to keep paying dividends are likely to adopt a cautious approach, given the high level of uncertainty. Many companies are having to currently suspend forward looking earnings guidance, as clearly there are too many 'unknowns' due to Covid-19.

In the UK for instance, the biggest banks Barclays, Royal Bank of Scotland, HSBC, Lloyds, Santander and Standard Chartered have all suspended dividend payments and share buybacks for 2019 and throughout 2020. The banks had been under pressure to do so from their Regulator, the Prudential Regulation Authority (PRA).

In addition, companies face having to postpone their Annual General Meetings and corporate reports due to the lockdown conditions. This means that dividend payments, that typically require a confirmatory vote by shareholders, may be delayed. Europe has a particularly concentrated dividend season with many shareholders elligible to receive a dividend falling over the next three months. The London Stock Exchange has announced that companies can delay their dividend payments by up to 30 business days.

As the current yield on the market does not reflect the dividends that companies will be able to pay, it is likely to begin to fall over the coming months. The question is by how much?

With so much uncertainty, it is difficult to predict what will follow. Depending on the course of the crisis we could see anything from a V shaped recovery to a global depression. The Global Financial Crisis of 2008 to 2009 could provide a rough guide of what to expect.

Dividend income fell by 18% globally in US$ terms and 15% in the UK over 2009 and 2010. The current dividend yield of the UK market is now over 6% with recent falls in capital value. Even from the current lower values, if it fell by 25%, UK equities would still yield over 4.5%, which is still attractive in the context of many other asset classes.

Around the world, companies in different markets have adopted different approaches to returning cash to shareholders, above what they require to sustain and grow their businesses.

In the UK and Europe, a 'dividend culture' has developed. Dividend yields in the Europe and the UK may take a long time to return to last year's level as companies are likely to become more structurally conservative when setting their dividend policies.

In Asia, dividend payments are not generally as high. Companies tend to hold higher levels of cash, reflecting memories of the Asian crisis and traditionally higher levels of family ownership. This should benefit companies across the region as they rebuild once the crisis starts to resolve.

In the US, share buybacks by companies have been particularly prevalent in recent years. This practice may come under much greater scrutiny from here, with some prominent companies that have returned billions of dollars to shareholders now asking for billions in state aid.

It is possible that we could begin to see more companies around the world adopt more conservative dividend policies along the lines of Asian businesses. However, the aftermath of past crises would suggest that while companies may change their behaviour for a couple of years, they often then revert to the way that things were before.

What does this mean for an income focused portfolio?

For the moment, income focused portfolios face a choice between narrowing their focus to companies that have not cut their dividends or accepting a cut in the portfolio's income distribution. It can make better sense to accept a cut in income distribution in the short term as companies that have cut their dividend to prioritise liquidity and solvency will often recover faster than those that are struggling to maintain their dividends.

Despite the intensity of events, we think this is the time for long-termism. In extreme circumstances, it is preferable to see a business protect its balance sheet than blindly pursue the maintenance of a dividend target set in a completely different environment. When a company makes an uneconomic decision to maintain their dividend, this can ultimately destroy shareholder value.

Above all, the fall in value of the Income Portfolio in particular, has been due to the sell off in small and mid cap UK stocks to a greater extent than global equivalents. Many of these UK stocks which have arguably been oversold, now represent fantastic value and should recover. But additionally, Beckford James' stock x-ray policy means the portfolio is only reliant on any single company for a very tiny part of the overall distribution, with each contributing no more than 1.5%-2% of the overall portfolio dividend distribution. This means that a suspension or reduction of dividend by many of these companies, should not dramatically affect the overall distribution.

The overall impact on the intrinsic value of a given business from a temporary dividend cut is extremely marginal and, for long-term investors, it is important not to lose track of that fact amid the short-term market noise.