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# FOCUS: YIELD

## Factor Investing

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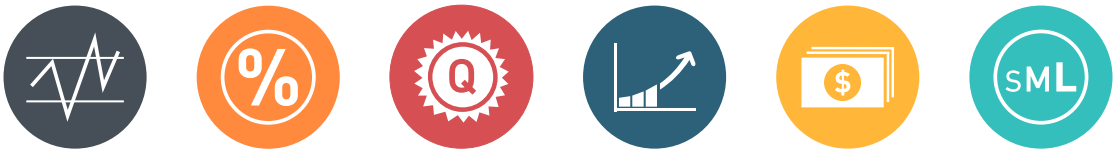


# FACTOR FOCUS: YIELD

IN THE REALM OF INVESTING, A FACTOR IS ANY CHARACTERISTIC THAT HELPS EXPLAIN THE LONG-TERM RISK AND RETURN PERFORMANCE OF AN ASSET. MSCI FACTOR INDEXES ARE DESIGNED TO CAPTURE THE RETURN OF FACTORS WHICH HAVE HISTORICALLY DEMONSTRATED EXCESS MARKET RETURNS OVER THE LONG RUN.

**MSCI Factor Indexes are rules-based, transparent indexes targeting stocks with favorable factor characteristics – as backed by robust academic findings and empirical results – and are designed for simple implementation, replicability, and use for both traditional passive and active mandates.**

## DEFINING YIELD

**A yield (or high dividend yield) investment strategy gains exposure to companies that appear undervalued and have demonstrated stable and increasing dividends.**

However, a naïve high-yielding equity strategy can be exposed to various "yield traps," such as those stemming from temporarily high earnings, high payouts or falling stock prices.

The MSCI High Dividend Yield Indexes focus on high dividend yield companies, but exclude companies that do not demonstrate dividend sustainability, dividend persistence and quality.

Securities that have passed these screens are considered for inclusion in the MSCI High Dividend Yield Index. Only those with a dividend yield at least 30% higher than the parent market-cap index are included.

The yield factor is categorized as a "defensive" factor, meaning it has tended to benefit during periods of economic contraction (see "Performance and Implementation").

The MSCI High Dividend Yield Index employs the following:

- Dividend sustainability screens to exclude both securities whose dividend payout is extremely high or negative, and therefore, where future dividend payments might be in jeopardy, as well as securities with high dividend yield resulting from a plunging stock price without fundamental support
- Dividend persistence screens to exclude securities without a good historical track record of consistent dividend payment
- Quality screens to exclude firms with low valuation and weak balance sheets that could fall into a "value trap".

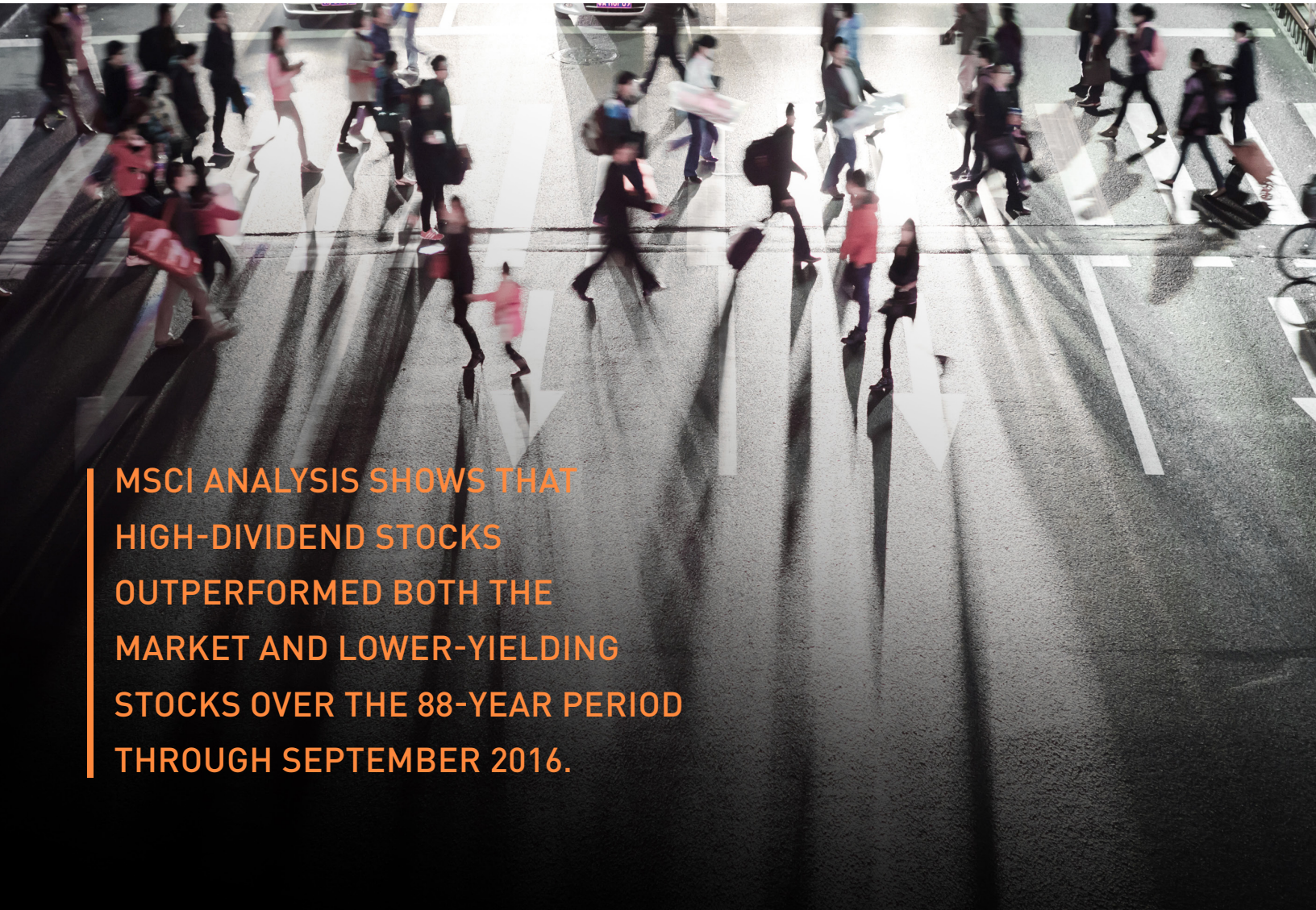
## WHY INSTITUTIONAL INVESTORS HAVE USED YIELD STRATEGIES

Investors may focus on the equity dividend income that is associated with the yield factor for a variety of purposes. Institutional investors seeking income outside of the fixed-income world have used the strategy. For instance, an insurance company that needs a regular income stream to pay out claims could tilt its portfolio to the yield factor to meet this objective. High dividends have also historically accounted for a large portion of long-term total portfolio returns.[1]

Dividend investing is as old as stocks themselves, playing a central role in the evolution of corporations over the centuries. Groundbreaking economists Benjamin Graham and David Dodd famously called dividend payouts "the prime purpose of a business corporation … A successful company is one that can pay dividends regularly and presumably increase the rate as time goes on."

Several theories seek to explain the superior performance of high-dividend stocks. One notes that yield investors have preferred dividend payouts in the present to uncertain capital gains in the future.[2]

They have also tended to view dividend increases as a sign of future profitability. A number of studies show that dividend yields have been strong indicators of earnings growth.[3]

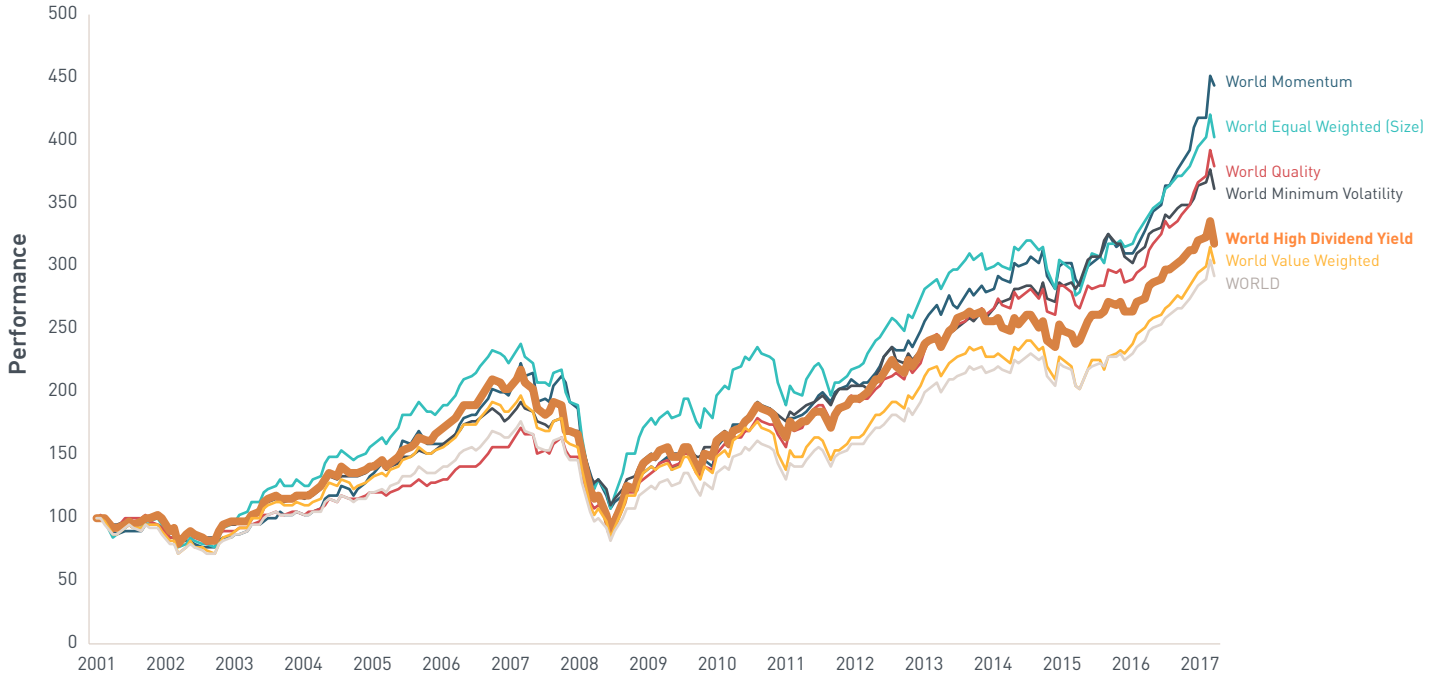


MSCI ANALYSIS SHOWS THAT HIGH-DIVIDEND STOCKS OUTPERFORMED BOTH THE MARKET AND LOWER-YIELDING STOCKS OVER THE 88-YEAR PERIOD THROUGH SEPTEMBER 2016.

# PERFORMANCE & IMPLEMENTATION

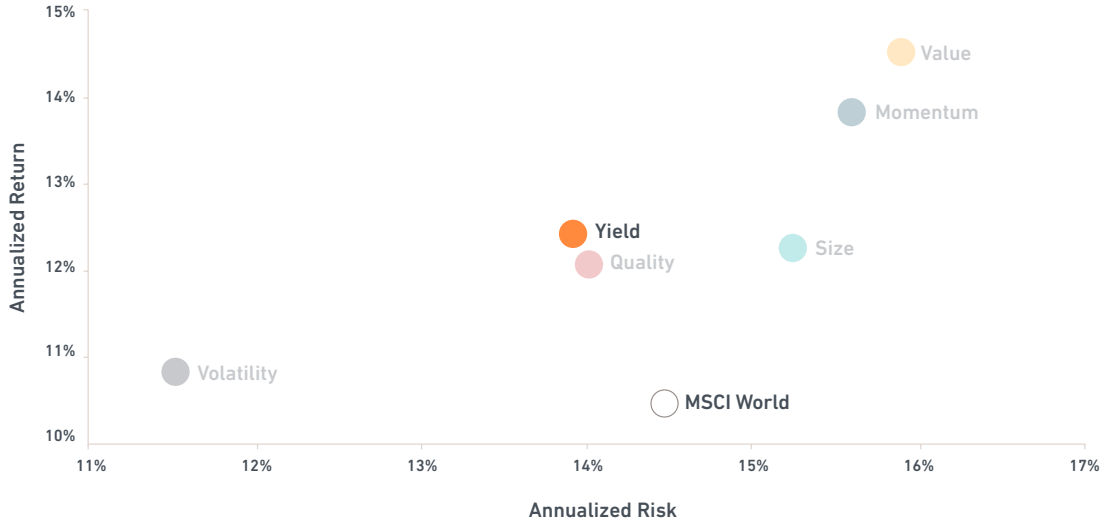
Over time, individual factors have delivered outperformance relative to the market (see chart below).

### MSCI WORLD FACTOR INDEXES




From a longer term perspective, the simulated MSCI World High Dividend Yield Index generated an annualized return of over 12% during a 40-year period (see chart below). In contrast to size, momentum, and value indexes, the MSCI World High Dividend Yield Index has realized a lower risk relative to the parent index.

### LONG-TERM PERFORMANCE: JANUARY 1977 TO DECEMBER 2017




Although factor strategies have exhibited long-term outperformance, in the short-term factor performance has been cyclical and has generated periods of underperformance.

## HOW THE SIX FACTORS HAVE PERFORMED RELATIVE TO EACH OTHER: YIELD

| 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 45.6% | 1.5% | -4.5% | -9.6% | 56.7% | 28.6% | 28.4% | 31.0% | 19.9% | -29.2% | 42.0% | 18.2% | 8.0% | 16.7% | 32.7% | 12.1% | 5.8% | 10.3% | 32.6% |
| 40.1% | 1.2% | -8.0% | -9.8% | 50.4% | 24.1% | 17.2% | 28.9% | 16.8% | -35.5% | 41.9% | 16.5% | 4.8% | 16.5% | 30.3% | 9.0% | 4.5% | 9.4% | 26.6% |
| 25.3% | 0.3% | -10.0% | -13.6% | 33.8% | 21.3% | 15.2% | 22.1% | 10.3% | -39.9% | 33.8% | 12.8% | 4.8% | 15.0% | 27.7% | 7.0% | 4.2% | 8.9% | 23.9% |
| 20.5% | -2.1% | -11.5% | -14.4% | 30.5% | 20.8% | 10.0% | 21.2% | 9.6% | -40.3% | 35.5% | 12.3% | 4.4% | 14.8% | 27.4% | 5.5% | -0.3% | 8.2% | 23.1% |
| 18.4% | -10.2% | -12.0% | -15.1% | 26.0% | 20.0% | 8.5% | 20.7% | 7.3% | -41.9% | 30.8% | 11.4% | -5.0% | 13.7% | 26.5% | 4.6% | -1.0% | 8.2% | 22.9% |
| 8.6% | -12.9% | -16.5% | -16.5% | 25.9% | 15.2% | 8.3% | 19.1% | 6.4% | -42.4% | 17.2% | 9.1% | -9.3% | 13.3% | 22.9% | 3.4% | -2.4% | 5.1% | 19.2% |
| 8.4% | -18.9% | -20.5% | -19.5% | 22.0% | 12.7% | 6.0% | 16.8% | 6.1% | -42.6% | 14.8% | 7.2% | -11.0% | 8.9% | 19.4% | 3.3% | -2.7% | 4.7% | 18.0% |

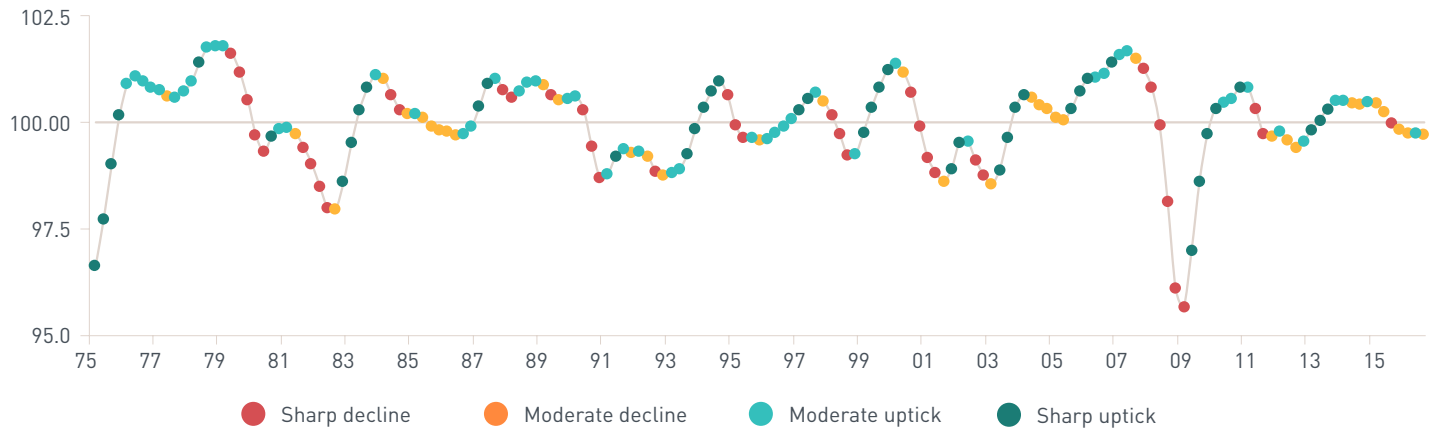
Volatility Yield Quality Momentum Value Size World

The analysis and observations in this report are limited solely to the period of the relevant historical data, backtest or simulation. Past performance — whether actual, back tested or simulated — is no indication or guarantee of future performance. None of the information or analysis herein is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision or asset allocation and should not be relied on as such.

The time periods covered in the charts in this paper were dictated by the data available when we conducted the simulations which produced them.

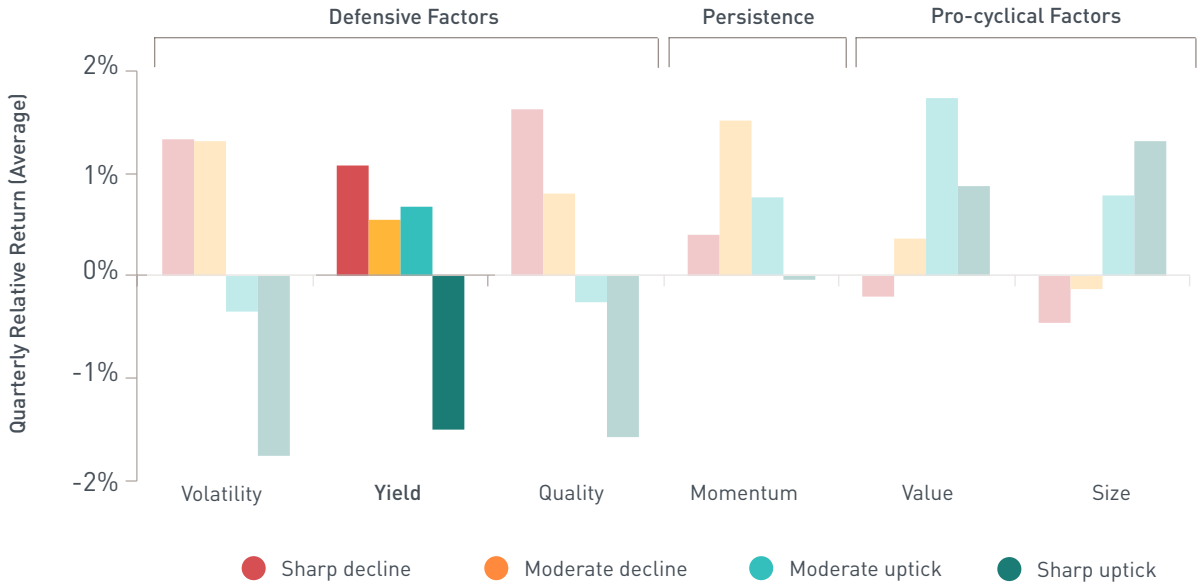
There are frequently material differences between backtested or simulated performance results and actual results subsequently achieved by any investment strategy

## MACRO EFFECTS ON FACTOR PERFORMANCE




In general, factor performance has been cyclical in nature. Individual factors have been shown to outperform during different macroeconomic environments. As the charts on this page illustrate, the high dividend yield factor falls into the "defensive" category, meaning that this type of strategy historically outperformed during declining market conditions over the study period.

**The Composite Leading Indicator used here, designed to provide early-warning signals on business-cycle turning points, is an aggregate time series displaying a reasonably consistent leading relationship with the reference series for the macroeconomic cycle.**




Data from November 28, 1975 to September 30, 2016.

# YIELD

## CONCLUSION

**High-yield equity factor investing involves screening for sustainably high dividends. It has provided yield income with equity market participation. The MSCI High Dividend Yield Indexes aim to represent the performance of companies that have historically demonstrated stable and increasing dividends, while mitigating risks against value traps. For yield seekers outside fixed income, the equity yield factor index has offered many attractive properties such as defensive income, a long-term positive risk premium and diversification to other factors.**

FOOTNOTES & REFERENCES


1 Wei Z., C. Chia and S. Katiyar. (2015)."Harvesting Equity Yield: Understanding Factor Investing." MSCI Research Insight.

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3 Arnott, R.D and C.S. Asness. (2003). "Surprise! Higher Dividends = Higher Earnings Growth." Financial Analysts Journal, Vol.59, No.1, pp. 70-87.

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