The U.S. stock market has had a spectacular run, but no one knows how long investors will be able to count on domestic equities for portfolio growth. How to achieve diversified, well-balanced exposure to growth opportunities is a question many investors are mulling over now. Dividend stocks may not seem an obvious answer given the traditional view of dividend-paying companies as sleepy and sluggish in comparison to dynamic up-and-coming growth stocks.

But investors who look past the stereotypes for opportunity may find their efforts rewarded. With an actively managed, research-based strategy, dividend stocks can provide investors with growth, income and risk management, too.

Contrary to their reputation, actively managed dividend strategies can serve growth as well as income and risk management objectives.

Highlights
Dividend-paying companies historically have provided higher total returns as well as a cushion against volatility.

Research also shows that dividend yields and payout ratios can help identify companies with strong prospects for stock appreciation.

This “dividend signal” operates both in the U.S. and in global markets, where information on companies is often harder to come by.

An active dividend signal strategy may help investors pursue retirement income, higher total returns and more global diversification.
Why a Global Dividend Strategy?

1. Dividend-paying companies historically have outperformed.

When the cumulative returns of equity income mutual funds (which invest in stocks with higher dividend yields) are compared to returns generated by growth funds over the past 15 years, the reasons to consider a dividend strategy are apparent (Figure 1). Equity income funds generated a cumulative, asset-weighted average total return of 127.9% since the beginning of 2000 compared to 92.8% among growth funds.

Research refutes the assumption that dividend-paying and nondividend-paying companies have comparable returns.
2. Yields are higher overseas.

Many international markets—in fact, a majority of G20 economies—offer dividend yields higher than those in the U.S. (Figure 2). Moreover, dividend tax rates also tend to be lower outside the U.S. Having struggled to find income in the low-rate environment that has prevailed in this decade, investors can ill afford to ignore opportunities overseas.

![Figure 2]

**Dividend Yields Higher Abroad**

Average Equity Dividend Yields in G20 Economies, as of August 31, 2015

Source: Bloomberg

Past performance does not guarantee future results.

3. Dividends can signal growth potential.

Intuitively, one might assume that companies grow faster by retaining more earnings rather than paying them out as dividends. It turns out, however, that both macro and individual company studies have confirmed a strong positive correlation between dividend payouts and subsequent earnings growth.¹ Research shows that dividend patterns can transmit signals about the business models, managements and prospects of the companies paying the dividends.

While this dividend signal phenomenon holds true in the U.S., it may be even more useful when investing abroad, where accurate, consistent company information may not always be available. Geographic distance is just one barrier. Differences in language, regulatory regimes, transparency, liquidity and accounting standards all pose challenges for investors seeking high-quality companies, as do currency fluctuations. At a time when Americans’ investment strategies are becoming more globally diversified than ever before, dividends may offer one of the best road maps available to help investors navigate the global equity landscape.
Why Do Dividend Payers Outperform?

Several factors help explain this dynamic. Dividends:

- **Can help mitigate potential downside risk.** In times of market downturns or high volatility, investors tend to place a higher value on companies that pay healthy dividends and appear able to sustain them. In effect, dividend yields may function as a shock absorber that helps support the price of high-dividend-paying stocks even when stocks are generally declining.

- **Encourage management discipline.** A corporate board of directors that is devoted to the regular, ongoing payment of a cash dividend may make corporate executives be better stewards of investor capital. Managers who budget for cash dividends may be less prone to make dilutive acquisitions, overspend on research and development or devote capital to projects that do not add value.

- **Provide tangible, unadulterated evidence of positive operational performance.** While companies might be able to use accounting maneuvers to put their financials in a more positive light, they cannot fake or manipulate a dividend check.

Added Advantages Abroad

In markets with a less efficient flow of information, dividends can be of even greater value, offering:

- **Information that is otherwise difficult to obtain.** Investors can glean much about a company, its management and its management’s view of future prospects for the company from dividend yields, their frequency and their payout ratios.

- **Reassurance to minority shareholders.** In some markets, it is common for founders and their families to retain a majority interest even after taking a business public. This can leave minority shareholders feeling bereft of influence over corporate actions. By benefiting all shareholders equally, significant and steady cash dividends can help allay such fears.

- **An indicator of management confidence in a company’s future.** By raising or initiating a cash dividend, companies are conveying positive information to market participants and telegraphing their confidence in the company’s future. This indicator can be particularly important in emerging markets, where a dividend hike frequently results in a more pronounced bump to stock prices than would a comparable action in the U.S.
High yield alone isn’t a good indicator of a stock’s total return potential. Payout ratios matter, too.

Research shows that the patterns of dividend yields and payout ratios provide insights that can be translated into active investment strategies. Studies have found that:

• **The highest-yielding stocks don’t necessarily deliver the best overall results.** Research by Credit Suisse has shown that, in terms of total return over time, the top decile of dividend-paying stocks consistently underperform those in the eighth and ninth deciles (Figure 3). This data shows why investors shouldn’t automatically reach for the stocks with the highest yield.

• **Historically, a high dividend yield with a low payout ratio has been the winning combination.** Another Credit Suisse research effort examined performance of stocks in 12 countries, including the U.S., over a 22-year period. That team found that over the course of the study period:

  - A high dividend yield combined with a low payout ratio produced the highest total return in nine of the 12 countries studied.
  - In the remaining three countries, a high dividend yield combined with a high payout ratio produced the best results.
  - Those results were consistent across regions, including the United States, Europe and Asia.

These findings suggest that companies with a consistently high payout ratio may not be reinvesting enough capital to fuel their future growth. It’s also important to note, however, that a payout ratio that is too low may reflect a lack of commitment to the dividend.
Using the Dividend Signal Approach

Dividend strategies are becoming increasingly relevant to investors as interest rates remain low and baby boomers retire in growing numbers. Actively managed dividend portfolios may be attractive to investors who worry that inflation could erode the value of a fixed-income stream. While stock dividends are also sensitive to inflation, they are considerably more flexible.

Dividend stocks may hold appeal for investors who are seeking:

- **Higher total returns** to boost their asset growth.
- **An alternative to fixed-income securities** that would lose value as interest rates rise.
- **Volatility and risk management**, as dividend stocks have tended to hold more of their value during market downturns.³
- **More global diversification** of their portfolios in line with the shifting global economic landscape. Emerging and frontier markets now represent 69% of the world’s population and 37% of global gross domestic product (GDP).⁴ Researchers have found dividend analysis to be a particularly useful tool for identifying growth opportunities in the context of global or emerging markets.

Taking advantage of dividend stock opportunities need not be complicated. One approach would be to incrementally allocate assets to global dividend strategies to increase international and emerging market exposure. Another method would be to shift some assets from fixed-income investments to dividend-paying shares to diversify income sources. This approach might not only generate more income, but could also better position investors who sought safety in bonds but now find their fixed-income holdings at risk from an interest rate rise.

In sum, research shows that dividend-paying companies historically have provided higher total returns and a cushion against volatility, both in the U.S. and in international and emerging markets. These findings can be translated into strategies that use dividend yields and payout ratios as a signal to identify high-quality companies with strong prospects for stock appreciation.

To learn more about the Dividend Signal Strategy approach, call us at **(888) 312-4100** or contact your personal sales representative.
4. All figures from the World Bank Databank, as of December 31, 2014.

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Diversification and asset allocation do not assure profit or protect against loss.
There is no guarantee the companies in our portfolio will continue to pay dividends.

Definition of Terms
Cumulative returns are the aggregate amount that an investment has gained or lost over time, independent of the period of time involved.
Dividend signal is an investment theory that suggests that a company’s announcement of an increase in dividend payouts acts as an indicator that the firm possesses strong future prospects.
Dividend yield is a financial ratio that shows how much a company pays out in dividends each year relative to its share price.
Group of 20 (G-20) is a forum of finance ministers and central bank governors from 19 of the world’s largest economies and the European Union. Formed in 1999, the group discusses key issues related to the global economy and promotes economic development around the world.
Payout ratio is the percentage of earnings paid out in dividends to shareholders.
S&P 500 Index is an unmanaged index of 500 common stocks chosen to reflect the industries in the U.S. economy.
Transparency is the extent to which investors have ready access to any required financial information about a company such as price levels, market depth and audited financial reports.
Volatility is a statistical measure of the dispersion of returns for a given security or market index.
One cannot invest directly in an index.
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