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Opinion

A case for Asian dividend strategies

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With the U.S. Federal Reserve delaying changes to reduce its bond purchase programme, the low-rate environment is unlikely to change for some time. Against this backdrop, investors seeking stable income will likely continue their ongoing quest for high-yielding instruments. Dividend stocks in the Asia-Pacific region present a strong case for this strategy.

As various academic studies indicate, a high-dividend strategy combined with a value investing approach has worked well in Asia. According to research by the Hong Kong University of Science and Technology (HKUST), Hong Kong-listed value stocks – screened based on price-to-earnings ratio and dividend yield – have outperformed the Hang Seng Index (HSI) by 29 times since 1990. Due to the nature of high-dividend companies being inherently more stable businesses, HKUST research finds that, during the global financial crisis, dividend yield-based value investing strategies recorded a decline of about 32% between October 2007 and October 2008. These results are more attractive than the HSI's performance, as that index declined by 52% over the same time period.

The high-dividend stocks approach is also supported by market analysts. To quote Bank of America Merrill Lynch's Asia Pacific Quant Strategy, "Our back-testing over the long term [from January 1989 to October 2009] showed value was the best-performing Asia-Pac quintessential style," adding 4% annually, on average, closely followed by nearly 4% increase in dividend. In fact, the MSCI Asia-Pacific ex-Japan High Dividend Index returned 188% from the beginning of 2000 to Oct. 30, 2013, outrunning the 86% for the MSCI Asia Pacific ex-Japan Index in the same period.

We recommend a strict bottom-up selection approach focusing on dividend yield, with non-benchmark country allocation. A combination of high-dividend yield strategies is designed to help meet the fund's investment objective of delivering stable returns.

To identify high-dividend stocks, we focus on businesses with the ability to pay dividends; for example, those with strong cash flows from operations. We also focus on businesses with the willingness to pay dividends, which means management's incentives are aligned with investors to return profitability to shareholders in the form of dividends. Additionally, we are interested in businesses with stable earnings, which have a more predictable level of profitability and not-too-high gearing level. Lastly, we look for businesses that do not pay too much, meaning the company has the ability to further increase dividend payout in the future.

Overall, investors would be better off embracing a combination of two types of high-yielding stocks: stable high yield and cyclical high yield. For stable high-yield stocks, we look for companies with stable and mature businesses. These businesses are typically large-cap companies that generate cash faster than their reinvestment needs. These can be understood as conventional high-yield stocks. An example of such a stock is a Chinese bank, the valuations of which remain low as compared to other banks across Asia. Chinese banks operate in traditional banking business models, and concerns about their asset quality are already well priced into their stock prices. Fundamentally, we expect Chinese banks' earnings momentum to remain strong, while maintaining a high level of dividend yield.

Cyclical high-yield stocks are also a key component of our portfolio. These are "disguised" high-yield stocks – their high yield is not necessarily due to a high level of payout but, rather, due to their low share prices. These investments are typically in small- and mid-cap companies that are emerging from a difficult environment while maintaining their dividend commitments. For example, we have been investing in one of the leading apparel manufacturers in the export industry in China. The company derived a majority of its revenues from international sales, and investors have been cautious toward exporters in an environment of slowing developed market growth over the past few years. The company, despite headwinds, has maintained its leadership role in the industry, with quick order turnaround time. These attributes make it highly desired by brand owners, especially in today's fast fashion model. The result is that the company continues to gain market share and has helped generate very significant returns for the portfolio.

We believe high-dividend investments remain attractive in this environment, and we are increasingly confident that our differentiated strategy in investing in this space adopted over the past decade will continue to deliver returns to our customers.