RSMR WEEKLY BROADCAST

EDITION THIRTY THREE: 12TH MAY 2020

With dividend cuts, where do investors get their income from now?

As we explored in a previous broadcast, the UK has a dividend-paying culture. Dividends have been an important source of returns since 1926 and investors have grown used to ever-increasing dividend payments over the last ten years.

The top 10 companies in the UK pay the lion's share of dividends and have maintained this pay-out strategy for decades. Companies have even borrowed money in the short term to ensure that they can cover their dividend pay-outs. To illustrate the importance of dividends, if you held shares over 10 years, around 57% of your total return would come from income in the form of dividends, rather than from the actual shares going up in value.

As the coronavirus pandemic shuts down economies across the globe, companies are looking to cut costs, preserve liquidity, and reduce debt to stave off the dramatic consequences of economic collapse. They are aiming to strengthen their balance sheets and one method that companies are using to conserve cash is to cut back on or eliminate their dividend pay-outs. In some companies, dividends are being reset at a lower rate, meaning that there will be a substantial decrease in the amount paid to investors, shareholders and pension funds this year. In other companies, dividends are being cut altogether.

According to data from fund shop AJ Bell, a total of 314 companies have suspended or removed their dividends, worth more than £29bn, while 118 companies have forged ahead with their pay-outs at a value of £10bn. Every day has brought a new wave of companies scrapping dividends and BT and Shell are some of the latest high-profile businesses to join the crowd. It's the first time Shell have cut dividends since World War II.

So, the big question is, where do investors get their income from now?

People's expectations will have to change as they accept that the income yield is going to be lower for some time. Interest rates have been cut, meaning that traditional bonds are paying lower rates of income. To achieve higher income, you could accept a higher level of risk, but this isn't a strategy for the faint hearted.

What about investment trusts? Investment funds pay out all the income that they generate so if there isn't a significant income, they don't pay out in great quantities, but investment trusts have a different structure. As a closed-end investment, they don't have to pay out all their income each year, meaning that they can build up reserves from saving small amounts on an annual basis, so there is a higher chance that income can be maintained. They also have the benefit of looking at other asset classes that are less liquid. Alternative investments such as those weighted towards infrastructure may be an interesting option as they have secure and regulated income and the underlying investments are generally backed by the government.

How about a more global outlook? Global dividends from parts of the world that are not as affected by the current crisis could be more resilient. You can also get exposure to other sectors such as IT companies and businesses that are thriving during this time - Amazon is an example. These companies have resilient business models with strong balance sheets, and they have the financial resources to avoid dividend cuts. The quality aspect of these companies is significant in that any income they do produce is more secure, even during extremely testing times.

There is clearly a lot of uncertainty in the world and no-one really knows how this will play out but looking for income from the less traditional sources could be an interesting way forward.

QUIZ: By how much is Shell cutting its dividend from the first quarter of this year?

LAST WEEK'S ANSWER: Wind power is the UK's strongest source of renewable energy.