LEGG MASON
GLOBAL ASSET MANAGEMENT

1018 I 2018

ASIA CONVERSATION

This week we catch up with Kathleen Anderson, Director at Legg Mason affiliate, ClearBridge Investments. Based in the US, she covers US equity strategies and has over 20 years of investment industry experience.

Q1) Does the current economic environment augur well for a dividend focused strategy?

Yes, we remain positive about the outlook for the U.S. equity market and dividend-focused strategies. We expect earnings results for the remainder of 2018 to be strong, as the U.S. continues to generate solid economic growth. We are monitoring the risks of a global trade war — which would be negative for global equity markets — but the risks appear to be receding somewhat with the recent announcement of a revised North American Free Trade Agreement. Our view is that focusing on companies with sound or improving balance sheets, attractive current dividend yields and dividend growth potential is a sound course in the current environment.

Q2) Why are dividend stocks less volatile than others?

The relatively lower volatility of dividend stocks stems from the stability of their revenue and earnings. Dividend payers tend to be more mature companies with business models that benefit from more stable cash flows; they also often have less economic sensitivity than more volatile companies in cyclical industries. In addition, from a total returns point of view, dividends comprised a large portion of performance over the last 20 years. Having regular dividends can boost returns during market upswings while also cushion performance during market down turns. [CHART 1 & 2]

Q3) Which is more important? Growing dividends or high dividends.

High current dividends can of course be important, but the ability to grow and compound dividends over time is likely a better indicator of a disciplined company with a sound or improving balance sheet, solid returns and relatively predictable earnings and cash flow streams, which are the companies we prefer.

Q4) Walk us through why the following sectors could be favourable for investors looking for dividends

a) Information Technology

Information technology companies, while still predominantly growth-oriented, are increasingly distributing dividends as technology and business models mature and cash flows become more predictable. Many dividend-paying IT companies also tend to grow their distributions at a solid rate.

b) Energy – Infra

We believe the U.S. renaissance in energy production represents a secular growth opportunity and is attractive for the long-term investor. In our assessment, energy production in the U.S. remains in a good position to increase over time. In the short and medium term, growth of hydrocarbon production has continued to increase, a result of a rising U.S. rig count and strong oil prices. With energy stocks offering high yields and trading down despite rising energy production and prices, we find the outlook favorable.

c) Financials

Several factors are helping financials look favorable for dividend investors. They are largely domestically focused and have benefited from recent tax cuts, which have helped boost profits. Deregulation has also increased the amount financials can pay out of their earnings in the form of dividends. Financials also stand to benefit from a rising interest rate environment, which helps net income margins. For these reasons, bank payout ratios are going up.

d) Real Estate

The cash flows from commercial real estate are primarily contractual in nature, which gives them stability and predictability. The U.S. Real Estate Investment Trust structure requires the companies to pay out a minimum dividend of 90% of taxable income to shareholders, which places a floor under distributions and can also act as an impetus to push distributions higher if a company is close to the minimum required payout and its cash flows continue to grow. We continue to be modestly optimistic about the outlook for the U.S. real estate market, but higher long-term interest rates will continue to present challenges. We expect real estate earnings growth to be respectable, but unspectacular, in the second half of 2018. However, real estate fundamentals may benefit from the increased strength in the U.S. economy. We think valuations are moderately attractive at current levels.

Source: Legg Mason, Clearbridge Investments, as at 18 October 2018. All data and estimates as at 28 September 2018 unless otherwise stated. **Past performance is not an indication of future returns.**

ONLY FOR USE WITH ALL INVESTORS IN HONG KONG AND SINGAPORE, THE PRC INVESTORS INVESTING IN THE QDII PRODUCT OFFERED BY PRC'S COMMERCIAL BANK, DISTRIBUTORS AND EXISTING INVESTORS IN KOREA, DISTRIBUTORS IN MACAU AND ALL INVESTORS IN TAIWAN. PLEASE REFER TO THE IMPORTANT INFORMATION ON THE FINAL PAGE.

Q5) Are dividend stocks still attractive from a valuations point of view? Is it too late for investors to start investing in one?

Nine years into a bull market, valuations for the broad market are high on a trailing basis but much less so on a forward basis. The U.S. economy is exhibiting strong growth, translating into higher revenues, earnings, free cash flow and dividends for many companies. This growth trajectory is offsetting headwinds from higher interest rates and a trade dispute with China. There are pockets of rich valuations in the market, notably the high-performing technology stocks, but we find many of dividend paying stocks to be at attractive valuations. Our view on the prospect for dividend growth is also positive as the tax reform is lifting after tax earnings and cash flow and the repatriation of foreign profits is providing a boost to U.S. based cash balances.

CHART 1 & 2 :Of the 318% of S&P500 total returns, 169% came from capital gains while 149% were derived from dividends.
CHART 1& 2 Source: Bloomberg, Standard and Poor's. Data as at 28 September 2018.

CHART 1: The S&P 500 experienced a total return of 318% from 30 September 1998 to 28 September 2018

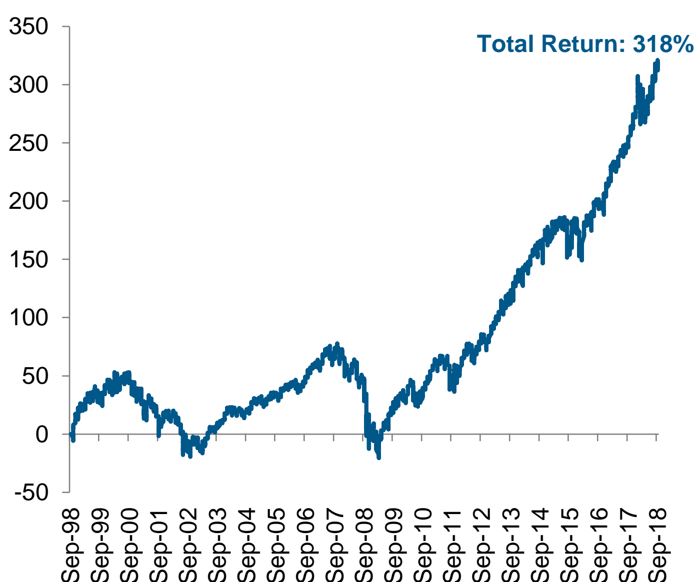
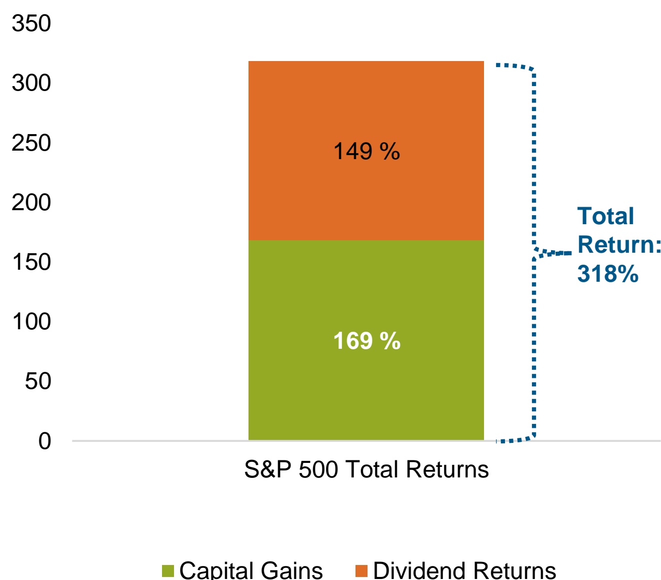


CHART 2: Dividends comprised the majority of performance over the last 20 years (%)



END

Source: Legg Mason, Clearbridge Investments, as at 18 October 2018. All data and estimates as at 28 September 2018 unless otherwise stated. **Past performance is not an indication of future returns.**

ONLY FOR USE WITH ALL INVESTORS IN HONG KONG AND SINGAPORE, THE PRC INVESTORS INVESTING IN THE QDII PRODUCT OFFERED BY PRC'S COMMERCIAL BANK, DISTRIBUTORS AND EXISTING INVESTORS IN KOREA, DISTRIBUTORS IN MACAU AND ALL INVESTORS IN TAIWAN. PLEASE REFER TO THE IMPORTANT INFORMATION ON THE FINAL PAGE.

IMPORTANT INFORMATION:
This document is based on an update from Clearbridge Investment, a subsidiary of Legg Mason. The views expressed are opinions of Kathleen Andersen, US Equity Investment Specialist as of the date of this material and are subject to change based on market and other conditions without notice and may differ from other investment professionals or from those of the firm as a whole.

Source: Legg Mason, Clearbridge Investments, as at 18 October 2018. All data and estimates as at 28 September 2018 unless otherwise stated.

All investments involve risk, including possible loss of principal.
The value of investments and the income from them can go down as well as up and investors may not get back the amounts originally invested, and can be affected by changes in interest rates, in exchange rates, general market conditions, political, social and economic developments and other variable factors. Investment involves risks including but not limited to, possible delays in payments and loss of income or capital. Neither Legg Mason nor any of its affiliates guarantees any rate of return or the return of capital invested.
Equity securities are subject to price fluctuation and possible loss of principal. Fixed-income securities involve interest rate, credit, inflation and reinvestment risks; and possible loss of principal. As interest rates rise, the value of fixed income securities falls. International investments are subject to special risks including currency fluctuations, social, economic and political uncertainties, which could increase volatility. These risks are magnified in emerging markets.
Commodities and currencies contain heightened risk that include market, political, regulatory, and natural conditions and may not be suitable for all investors.
Past performance is no guarantee of future results. Please note that an investor cannot invest directly in an index. Unmanaged index returns do not reflect any fees, expenses or sales charges.
The opinions and views expressed herein are not intended to be relied upon as a prediction or forecast of actual future events or performance, or a guarantee of future results, recommendations or advice. Statements made in this material are not intended as buy or sell recommendations of any securities. Forward-looking statements are subject to uncertainties that could cause actual developments and results to differ materially from the expectations expressed. This information has been prepared from sources believed reliable but the accuracy and completeness of the information cannot be guaranteed and is not a complete summary or statement of all available data. Individual securities mentioned are intended as examples of portfolio holdings and are not intended as buy or sell recommendations. Information and opinions expressed by either Legg Mason or its affiliates are current as at the date indicated, are subject to change without notice, and do not take into account the particular investment objectives, financial situation or needs of individual investors.
The information in this material is confidential and proprietary and may not be used other than by the intended user. Neither Legg Mason or its affiliates or any of their officer or employee of Legg Mason accepts any liability whatsoever for any loss arising from any use of this material or its contents. This material may not be reproduced, distributed or published without prior written permission from Legg Mason. Distribution of this material may be restricted in certain jurisdictions. Any persons coming into possession of this material should seek advice for details of, and observe such restrictions (if any).
This material may have been prepared by an advisor or entity affiliated with an entity mentioned below through common control and ownership by Legg Mason, Inc. Unless otherwise noted the “$” (dollar sign) represents U.S. Dollars.
All Investors in Hong Kong and Singapore:
This material is provided by Legg Mason Asset Management Hong Kong Limited in Hong Kong and Legg Mason Asset Management Singapore Pte. Limited (Registration Number (UEN): 200007942R) in Singapore.
This material has not been reviewed by the Securities and Futures Commission in Hong Kong. This advertisement or publication has not been reviewed by the Monetary Authority of Singapore.
Intended recipients in the People’s Republic of China ("PRC")(excluding Hong Kong, Macao and Taiwan for the purpose of this document):
This material is provided by Legg Mason Asset Management Hong Kong Limited to intended recipients in the PRC. The content of this document is only for the PRC investors investing in the QDII Product offered by PRC’s commercial bank in accordance with the regulation of China Banking Regulatory Commission. Investors should read the offering document prior to any subscription. Please seek advice from PRC’s commercial banks and/or other professional advisors, if necessary. Please note that Legg Mason and its affiliates are the Managers of the offshore funds invested by QDII Products only. Legg Mason and its affiliates are not authorised by any regulatory authority to conduct business or investment activities in China.
This material has not been reviewed by any regulatory authority in the PRC.
Distributors and existing investors in Korea:
This material is provided by Legg Mason Asset Management Hong Kong Limited to eligible recipients in Korea.
This material has not been reviewed by any regulatory authority in Korea.
Distributors in Macau:
If this document is distributed in Macau, this may not be used other than by the Distributors.
This document has not been reviewed by the Monetary Authority of Macao in Macau.
Issuer: Legg Mason Asset Management Hong Kong Limited.
All Investors in Taiwan:
This document is provided by Legg Mason Investments (Taiwan) Limited (Registration Number: (98) Jin Guan Tou Gu Xin Zi Di 001; Address: Suite E, 55F, Taipei 101 Tower, 7, Xin Yi Road, Section 5, Taipei 110, Taiwan, R.O.C.; Tel: (886) 2-8722 1666) in Taiwan. This document is for information only and does not constitute an offer or invitation to the public to purchase any shares in any fund in Taiwan.
Neither Legg Mason nor any officer or employee of Legg Mason accepts any liability whatsoever for any loss arising from any use of this document or its contents. The information in this document is proprietary. This document may not be reproduced, distributed or published without prior written permission from Legg Mason. Any person coming into possession of this document should seek advice for details of, and observe, such restrictions.
If the Press would like to re-edit the press release from their own point of view, it should base on the public information provided by the Legg Mason Investments (Taiwan) and the information contained in such press release shall be not over-promising or exaggerating.
Legg Mason Investments (Taiwan) Limited is operated and managed independently.