Market Perspectives

PRIVATE CLIENT SOLUTIONS

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US Dividend Investments in a COVID-19 World

As investors, we have been pleased to see some optimism return to equity markets in recent days. Relief rallies are always appreciated but not to be trusted in a bear market. The bounce back in share prices can be attributed to a few things:

- Short sellers covering winning bets.
- Institutional managers rebalancing portfolios going into quarter end.
- Reaction to positive news.

The third point is the most important causal factor for a market rebound, so with the US and Canada still in the throes of the crisis and no firm idea of when the economy will properly reopen, we believe the recent gains are more to do with trading vs. economic signals. There are definitely positive factors to point towards, including success in controlling the virus in China and Korea, the peaking of death rates in Italy, slowing infection rates in Canadian and US hot-spots, roll-out of fiscal stimulus and greater adherence to quarantines and social distancing. However, we continue to stress that economic data is sparse/incomplete and an end-game remains well into the future. As a result, we still do not think it is the time to be taking on significant risk in portfolios and investors should be looking at their investments much as they should their health, by hunkering down and concentrating on safety.

Last week we published a piece analyzing "go-to" Canadian dividend stocks and ranking their ability to maintain their dividends through the current economic downturn. This week we do the same for high quality US dividend payers. As the US stock market is much bigger than Canada, we are focusing on sub-sectors where we see the greatest evidence of dividend stability and give a few best ideas for each.

Seeking Shelter in Dividend-Paying Stocks

In our Canadian report, in terms of ranking the stability of dividends, we started at industries that provide the necessities of life (utilities, staples, communications) and worked our way from there into areas like gold, banks, railroads, pipelines and insurance. For the US we are taking a slightly different approach and focusing our analysis mostly on US dividend stocks that are globally dominant, financially secure, have significant competitive advantages and are most likely to come out the other side of the crisis in a position of strength. We also, focus on technology, health care and consumer stocks that

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are underrepresented in the S&P/TSX and therefore, key areas of the US market for Canada-centric portfolios looking for proper diversification.

We are using the same series of five qualitative metrics we used for the Canadian report, to give a basic overview of the safety of each industry groups' respective dividend payouts. However, for the US names we add a sixth category, "Global Leader/Moat". This refers to sectors of the US economy that contain large, multinationals that dominate their respective peer groups and have strong economic moats around their businesses. Moats will give added protection in the downturn, while providing a competitive advantage to consolidate and gain market share in the inevitable recovery. We then offer some best stock ideas within each category. Factors:

1. **Revenue & Earnings (EPS) Stability** – how likely the sector will be able to maintain its past income and profit profile through the crisis.
2. **Government & Regulatory** – how likely that government measures to fight COVID-19 and support key parts of the economy will benefit the sector.
3. **Weak Commodity Prices** – whether low energy and metals prices will help or hinder the sector.
4. **Low Interest Rates** - whether protracted low interest rates will help or hinder the sector and/or impact the value of the shares.
5. **Debt & Liquidity** – Whether the sector has strong balance sheets and ample capital liquidity to ride out the downturn.
6. **Market Leader/Moat** – companies that dominate their industry and/or have a significant economic moat (e.g. size and scale, intellectual property, switching costs, brand, logistics)

We rate each factor with a positive, neutral or negative mark. As such, these are generalizations to give investors a basic view of each segment. More in-depth comments are available on most of the individual names from Raymond James Financial's research analysts.

Utilities

Revenue & EPS Stability	✓	Low Interest Rates	✓
Government & Regulatory	✓	Debt & Liquidity	-
Weak Commodity Prices	✓	Market Leader/Moat	-

Like in Canada, utilities rank at the top of the list. Dividends from US electricity producers and providers will be better protected due to a supportive regulatory environment, cheaper coal and natural gas and lower interest rates. Picks:

1. **Nextera (NEE-US)**
2. **Vesta (VST-US)**

Consumer Staples

Revenue & EPS Stability	✓	Low Interest Rates	✓
Government & Regulatory	✓	Debt & Liquidity	-
Weak Commodity Prices	✓	Market Leader/Moat	✓

The US consumer staples sector is broader than its Canadian counterpart with strong grocery and retail chains but also boasting global food and beverage brands. Revenues should hold up very well, forced store closures are unlikely and cheap fuel will benefit margins. Picks:

1. **Walmart (WMT-US)**
2. **Kroger (KR-US)**
3. **Pepsi (PEP-US)**
4. **Clorox (CLX-US)**
5. **Mondelez (MDLZ-US)**

Telecom

Revenue & EPS Stability	✓	Low Interest Rates	✓
Government & Regulatory	✓	Debt & Liquidity	-
Weak Commodity Prices	-	Market Leader/Moat	✓

The United States' large national telecom carriers provide a source of more secure dividends due to size, scale and financials. Internet and cell phone providers will be more important in an era of increased remote working and telecommuting. This will be supplemented by the roll-out of 5G technology, with Verizon (VZ-US) and AT&T (T-US) being global leaders. Picks:

1. **Verizon (VZ-US)**
2. **AT&T (T-US)**

Technology – Software

Revenue & EPS Stability	✓	Low Interest Rates	-
Government & Regulatory	-	Debt & Liquidity	✓
Weak Commodity Prices	-	Market Leader/Moat	✓

Large US software providers come in near the top of our list because they fall into many large investment themes that were relevant before COVID-19 and become even more important in its wake. Key themes include: cloud computing, ecommerce and remote work. On top of these tail winds, the software companies on our list have lower exposure to fixed costs and supply chain issues. They also are globally dominant players with high margins, massive free cash flow generation and typically, very low debt levels. All these factors make dividends more sustainable than most. Of note, a number of names that are not on our list would be had they paid dividends (AMZN, GOOGL, FB). Our picks:

1. **Microsoft (MSFT-US)**
2. **Visa (V-US)**

Health Care

Revenue & EPS Stability	✓	Low Interest Rates	-
Government & Regulatory	✓	Debt & Liquidity	✓
Weak Commodity Prices	-	Market Leader/Moat	✓

The US stock market provides investors with the biggest, broadest and best access to global leaders in health care. COVID-19 will causes stresses in some areas of the industry but in general, the dividend companies highlighted here all fall, in whole or in part, within the realm of essential services. These include, pharmacies, pharmaceuticals, vaccine makers, biotechnology, medical devices and health insurers. Most of the picks on our list also have large moats, strong balance sheets and significant free cash flow generation - all factors that work well for dividend safety. Picks:

1. **CVS Health (CVS-US)**
2. **Merck & CO. (MRK-US)**
3. **Johnson & Johnson (JNJ-US)**
4. **Amgen (AMGN-US)**
5. **Medtronic (MDT-US)**
6. **United Heath (UNH-US)**

Technology – Hardware

Revenue & EPS Stability	-	Low Interest Rates	-
Government & Regulatory	-	Debt & Liquidity	✓
Weak Commodity Prices	-	Market Leader/Moat	✓

We rank the hardware group farther down the list than the software names because these companies have greater exposure to supply chain, labour and demand issues. That said, all three names highlighted here are global leaders, with large moats, fortress balance sheets and more than ready to withstand a prolonged economic downturn. Moreover, they also have large, multi-year investment themes at their back such as 5G networks, "internet of things", media streaming, artificial intelligence and automation. Their businesses may take longer to get back to normal but we still have high conviction in the safety of their dividends. Picks:

1. **Apple (AAPL-US)**
2. **Cisco (CSCO-US)**
3. **Broadcom (AVGO-US)**

Financials

Revenue & EPS Stability	✗	Low Interest Rates	-
Government & Regulatory	✓	Debt & Liquidity	✓
Weak Commodity Prices	-	Market Leader/Moat	✓

With US financials, in particular the banks, we have a similar note of caution to investors that these businesses are not as defensive as some investors perceive and their revenue and earnings can be severely impacted during large economic downturns. One needs to look no further than the 2008 financial crisis when many US banks and financial services were hurt so badly that there were bankruptcies, forced mergers and government bailouts. The good news this time around is many lessons have been learned from 2008 and capital and financial strength are materially stronger. We have three high quality picks within the space that should be able to maintain dividends and be in a strong market position when the US economy reopens. Picks:

1. **JPMorgan Chase (JPM-US)**
2. **Apollo Global Asset Management (APO-US)**
3. **Bank of America (BAC-US)**
4. **Blackrock (BLK-US)**

Consumer Discretionary

Revenue & EPS Stability	✗	**Low Interest Rates**	-
Government & Regulatory	✗	**Debt & Liquidity**	✓
Weak Commodity Prices	✓	**Market Leader/Moat**	✓

The consumer discretionary sector is one that we are largely downplaying in our investment strategy. As the name implies, many of the companies' services and products are discretionary in nature and are the first to be cut in times of economic crisis. Moreover, stay at home orders and social distancing policies will greatly impact foot-traffic and demand. However, digging deeper there are companies that are more defensive in nature, provide services that are less impacted by economic cycles and will rebound more quickly in a low interest rate environment. We are restricting our picks to the highest quality:

1. **Home Depot (HD-US)**
2. **Target (TGT-US)**

Industrials

Revenue & EPS Stability	✗	**Low Interest Rates**	✓
Government & Regulatory	-	**Debt & Liquidity**	✗
Weak Commodity Prices	-	**Market Leader/Moat**	✓

The industrials is another area we are mostly avoiding as many names are lower margin, capital intensive and will be hit hard by a weak economy. However, some areas of the US economy like defense spending, freight transportation and agriculture are more defensive in nature and will be quicker to return to normal. Picks:

1. **Lockheed Martin (LMT-US)**
2. **Union Pacific (UNP-US)**
3. **Deere & Co. (DE-US)**

Conclusion

This report covers the areas of the US market where investors typically go for dividend yield and/or growth. All of the names that we have listed here are very high quality companies that will survive the current economic downturn and most will likely thrive on the other side of it. However, because we still can't properly forecast how long and how severe the downturn will be, the thrust of this report is to give investors some context as to how safe we feel the dividends from different parts of the US economy are at this point in time, with a quality and conservative bias. As the crisis progresses and we get closer to the lifting of the extraordinary social/economic restrictions, our confidence in dividend safety will increase and our willingness to take on more risk will rise.

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