Generations ETFs episode 8: Sri Iyer
interview transcript
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Introduction
Welcome to Generation ETFs, brought to you by Horizons ETFs Management Canada Inc. This is a podcast series dedicated to the next generation of investing. I'm your host Donna Papacosta, and in this series, Generation ETFs will aim to educate and inspire investors to understand and be active in their portfolios by discussing market trends and investment strategies with the leading experts in the industry.

In this episode of Generation ETFs, you'll meet Sri Iyer. Sri is managing director and head of systematic strategies at Guardian Capital, where he helps lead the development and implementation of proprietary systematic strategies. In this conversation, Sri talks about the ins and outs of dividend investing.

Interview

Interviewer: Sri, at Guardian, you focus on dividend investing. Can you elaborate on why dividends are the cornerstone of your investment mandates?

Sri Iyer: Dividends represent two-thirds of all returns from equity markets over longer horizons, so it is imperative for active money managers like ourselves, to focus on dividend-paying companies that can give us upfront return with very little risk of the future. That results in a consistent return profile for investors who want to participate in equity markets.

Interviewer: Then are dividends important for investors who *don't* need the income?

Sri Iyer: There's a misnomer in the market that dividends are necessary only for income. We feel dividends are a component of the shareholder yield, and not just dividends only. When a company generates free cash flow, companies that pay dividends, signal to investors that they have the ability to grow their business and pay some dividends. By owning dividend-paying stocks, you're not only getting income, but you're also getting the stability, the better down-market capture, as well as less volatility during times of uncertainty. Dividend investors shouldn't be myopic about dividends as just a source of income. Dividends represent a more consistent return with less volatility, better down-market capture, and give you the ability to capture shareholder yield a lot more consistently than other approaches in equity investing.

Interviewer: Will dividend investors outperform the broad market over time?

Sri Iyer: Dividend investors have outperformed the broad market over time in the past. Amidst ensuing equity volatility and uncertainties in the interest rate markets around the global world, we feel that dividend stocks could add value to a portfolio's return by giving a sustained source of income, better downside protection, and a lot less volatility than the equity market in general.

Interviewer: Speaking of uncertainty, there's lots of uncertainty around U.S. interest rates and the Fed's next move. Can you talk about how interest rates affect dividend stocks?

Sri Iyer: Interest rates significantly affect dividend stocks, because people always choose stable income from bonds over income from equities. The tradeoff of selling bonds and buying equities is significant for a dividend investor. As interest rates start to go up, dividend stocks that pay excessive dividends could get hurt, because the options to buy bonds becomes that much more attractive. Yield for yield's sake, within the dividend space, could be extremely sensitive to interest rate cycles. So the objective is to buy stocks that pay a reasonable amount of dividends that is sustainable, do a fair share of buy-backs where it is necessary, and make sure that they don't have a lot of debt. When you combine reasonable dividends with low debt at a decent amount of buy-backs, you transcend from just dividend yield to shareholder yield. Shareholder yield is a significant source of sustainable return to the equity markets, in general.

Interviewer: So we wouldn't say it would be a winning strategy to just buy stocks with the highest dividends?

Sri Iyer: I would say so. Buying just utilities, telcos, tobacco, cheese and beer, is not dividends. You need to buy companies across the spectrum in the global markets, across all economic sectors, well-run companies that have positive cash flow, and source dividends in a more diversified way rather than a focused way. As I mentioned, yield for yield's sake, is not the right approach to dividends. The Horizons Global Dividend ETF has different segments of dividends within this portfolio. We have dividend payers, dividend achievers, and dividend growers.

Dividend payers have a high payout, but are necessary to sustain the income needs of investors. Dividend growers have a lesser yield but have greater sustainability and a lot more total return positivity, which is very important to sustain the total return of the portfolio, and we have dividend achievers. Those are companies that are not necessarily focused on paying a dividend, but are more focused on not cutting what they pay. There is a market for that, and the sustainability of companies that don't cut dividends is also a great way to participate in dividend-paying stocks.

Interviewer: The active Canadian ETF you run for Horizons ETFs or HAL has a very low weighting to financial stocks. Is this by design?

Sri Iyer: The Canadian dividend strategy through Horizons mirrors the global approach to investing. That is, have a more diversified source of income versus a focused source of income. The two main sources of income in Canada are banks and energy stocks. Because there's a lot of volatility in the energy stocks right now, the mad dash to quality has seen banks being the only credible source of dividends and sustainability for most Canadian investors. What is not seen is there are a lot of great companies within the TSX Composite or the overall broad market in Canada, that are doing extremely well and are able to provide positive cash flow on a year-by-year basis. Companies that do that and can provide a sustainable dividend payout are the kind of companies we focus on to complement the source of income that has traditionally come from banks and energy stocks.

Interviewer: In emerging markets, the quality of dividend-paying stocks may not be up to par, some people say, with the developed world, yet the emerging markets dividend strategy that you manage in the Horizons Active Emerging Markets Dividend ETF is very successful. To what do you attribute this?

Sri Iyer: Emerging markets' not having a quality bias is a misnomer. Every market has companies that are of good quality, well-managed and badly managed companies. If the money manager focuses on buying good, solid companies that are part of the global landscape, but in emerging market countries, that can have good practices, good accounting practices, good ethical practices, and generate positive cash flow, and it's our objective to pick those type of companies and build a portfolio of emerging market companies that can sustain a quality dividend, not necessarily a quality stock. If you can provide a quality dividend, by nature, you're buying a quality company. The approach of the Horizons Global or Emerging Market ETF is to focus on that spectrum of companies, regardless of what part of the world they are in, and the strength and the success of the Horizons Emerging Market Dividend Fund comes from the bias towards extreme good quality, global gorillas within the context of emerging market companies. With these two combinations, we have been able to do a reasonable return to the market with a very significant down-market capture.

Interviewer: Thanks very much, Sri.

Sri Iyer: Thank you very much.

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