Yep, it works on the way down too.

The notion that the value of an asset would rise with the sustainable increase in distributable cashflows from said asset is not a controversial notion in the business world. It is, however, not the accepted wisdom in the US stock market where the rules have been different for several decades, and where paying a dividend—even a rising one—is derided as giving up on growth. Despite that adverse environment, most US stocks when measured over long periods still observe the basic rules of business. In other words, stocks go up because dividends go up. That's the recurrent theme in *The Strategic Dividend Investor* (2011), *The Dividend Imperative* (2013), and, for portfolio construction, *Getting Back to Business* (2018). (Yes, I am fully aware that apparently completely different rules apply to the large, publicly traded tech companies that do not make any distributions. My argument is that they are an anomaly, one which will eventually revert to the norm.)

The data and basic math supporting this businesslike approach to investing is almost entirely on the "upside." The data sets show that over decades stocks rise more or less in line with their increasing dividends. But the math should also work on the way down too. It is just that it is hard to find companies that have cut their distributions repeatedly over long periods of time. Obviously in distress, such companies simply disappear from the data set. They go out of business, they get delisted, they declare bankruptcy, they get bought out or taken private, etc. But now and again, we get highly suggestive individual data points. Last week was one of those times.

On February 14, 2013, just over six years ago, a phone company based in Monroe Louisiana (it is easier for me from a compliance perspective not to name names) surprised the market and its investors by cutting its dividend and shifting its free cashflow to a share repurchase program. The distribution was slashed 25.5% from an annual rate of $2.90 to $2.16. That day, the shares fell from $41.69 to $32.27, or 22.6%. Exactly six years later, the company lowered the dividend again, this time from $2.16 to $1.00. While the first cut was unexpected, the second one came as less of a surprise as the company's shares had been trending down and the yield prior to the cut was nearly 15%. After the news came out, they traded down another 13% before rebounding a bit on Friday, when they closed at $13.74. So over a six year period, the annual distribution dropped from $2.90 to $1.00, a fall of 62%. The shares have dropped from $41.69 (prior to the 2013 cut) to $13.74 at the end of last week. That is a drop of 67%. While that is not a precise correlation, it is close enough to make the point that asset values follow cashflows, both up and down. Other examples are hard to come by, but they can be found.

A certain door-to-door cosmetics and personal care company founded in New York in 1886 has struggled in recent years after several strategy zig-zags and shifting customer preferences. The company announced a 74% cut in its dividend on November 1, 2012 from an annual level of $0.92 to a rate of $0.24. At that time, the company's shares were trading around $15.50 (though they had fallen from materially higher levels in prior years.). Three years later, in late 2015, the company's shares were trading at around $4.00, yes, 74% below the prior level, when the company announced a full suspension of the dividend and the sale of its US business to a private equity concern. I do not want to suggest false precision here; that the two drops were exactly 74% is more of a coincidence. The bigger point is that there will be a broad correlation—due to the obvious causal linkage—between the trajectory of distributable cashflows and changes in asset values.

The exception that may well prove the rule are the US banks during the past decade. Their share price and dividend history is, to put it mildly, all over the place, but generally US commercial banks have

recovered in both regards since the sub-prime lending crisis when most US banks cuts their dividends to nominal levels. I hesitate to draw major conclusions about them, however, due to the enormous externality—the massive US government intervention—that characterized the entire US financial sector for the last 10 years.

For companies without that government safety net, the regular rules will apply. Share prices will in some close measure follow the dividend over meaningful measurement periods. And the dividend will follow the basic cashflow and business trends. The task of the dividend investor, therefore, is to choose those companies that have the ability and inclination to generate and distribute a rising stream of income, and to avoid where possible those that can or will not. Investors won't get everyone one of those calls correct, but a diversified portfolio of income streams rising over time should shield investors from the occasional bad apple in the cart.

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