



Discussion of “Monetary Policy and Reaching for Income”

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How an Investor SHOULD Think About Dividends



- Dividends are irrelevant without frictions (M&M)
- Adding costs can break the indifference:
 - Taxes on dividends or capital gains, transaction costs
- But investors still indifferent after taxes and costs
 - Don't *intrinsically* care about dividends, just minimizing costs
- Positive versus normative
 - Is this how people *actually* think about dividends?



MACMILLAN DICTIONARY

pay dividends - definition and synonyms



to bring you a lot of benefit

Thorough lesson planning always pays dividends.

 Synonyms and related words



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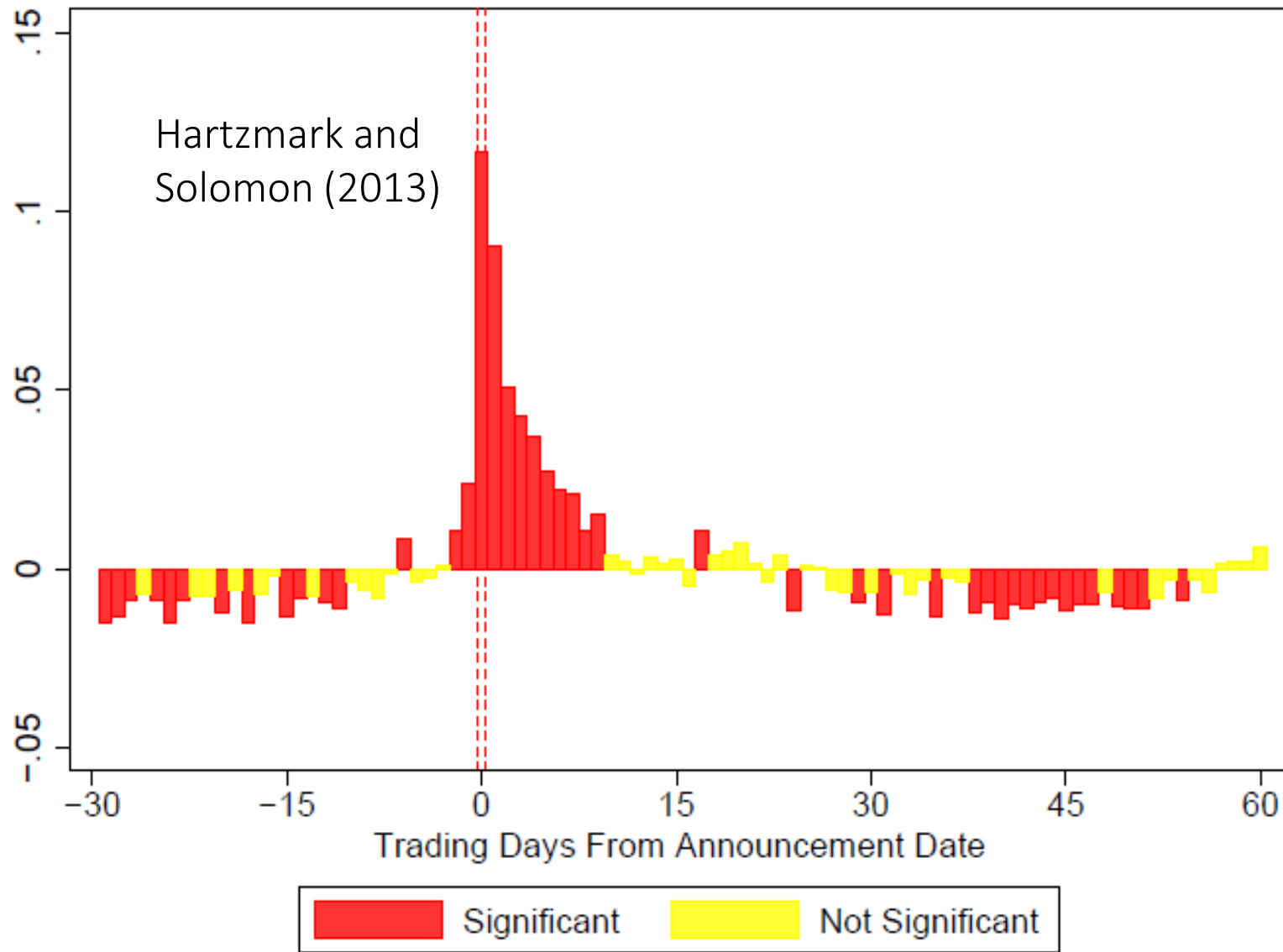


People LOVE dividends

- People talk as if they really like dividends. But why?
- Evidence of demand in financial markets as well
 - Companies increase dividends in response to proxies for dividend demand (Catering, Baker & Wurgler (2004))
 - Elderly investors more likely to purchase dividend-paying assets (Clienteles, Graham & Kumar (2006))
 - Price pressure around dividend-payment (Hartzmark & Solomon (2013))

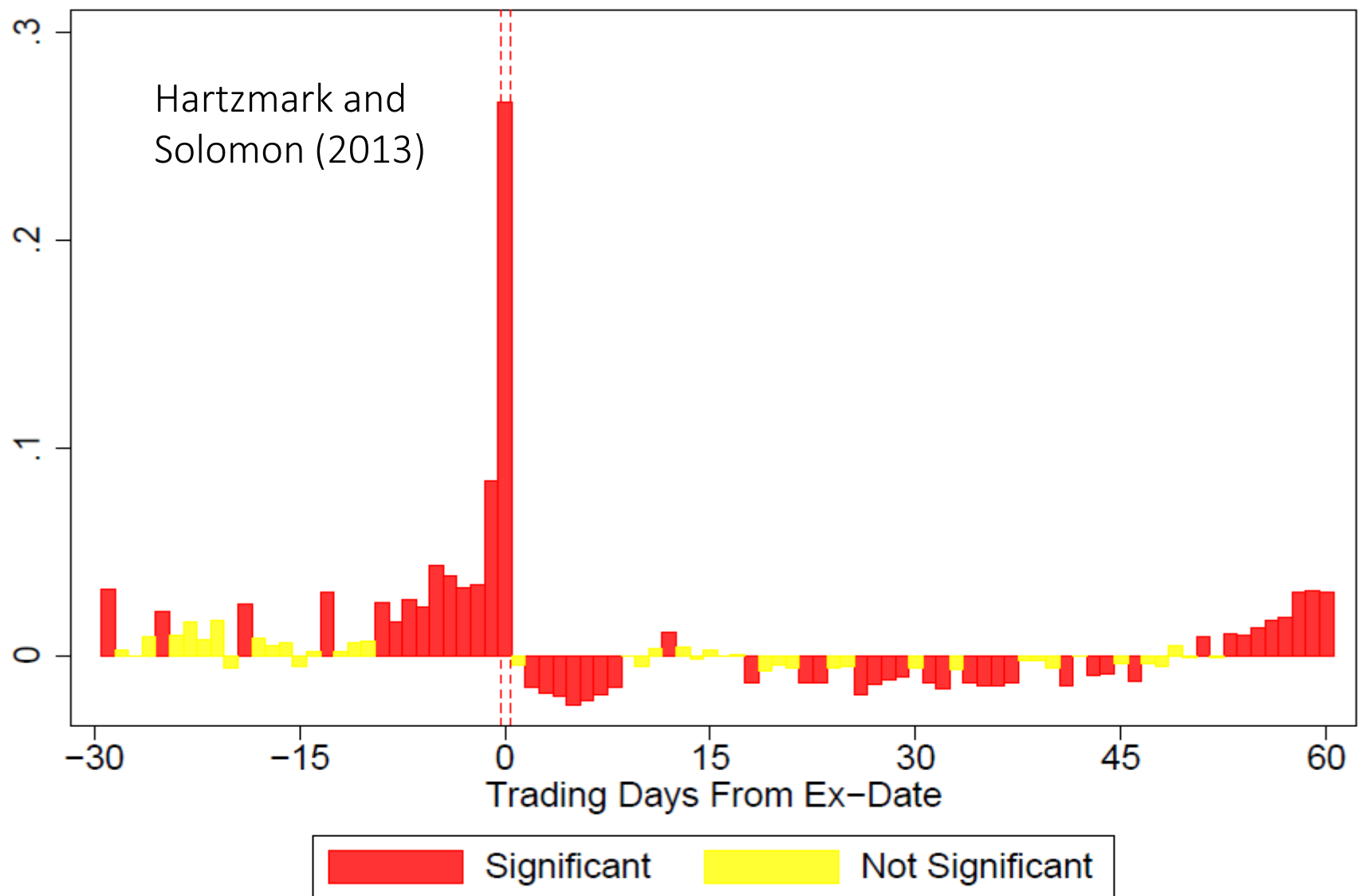


Interim Returns for Dividend Payers

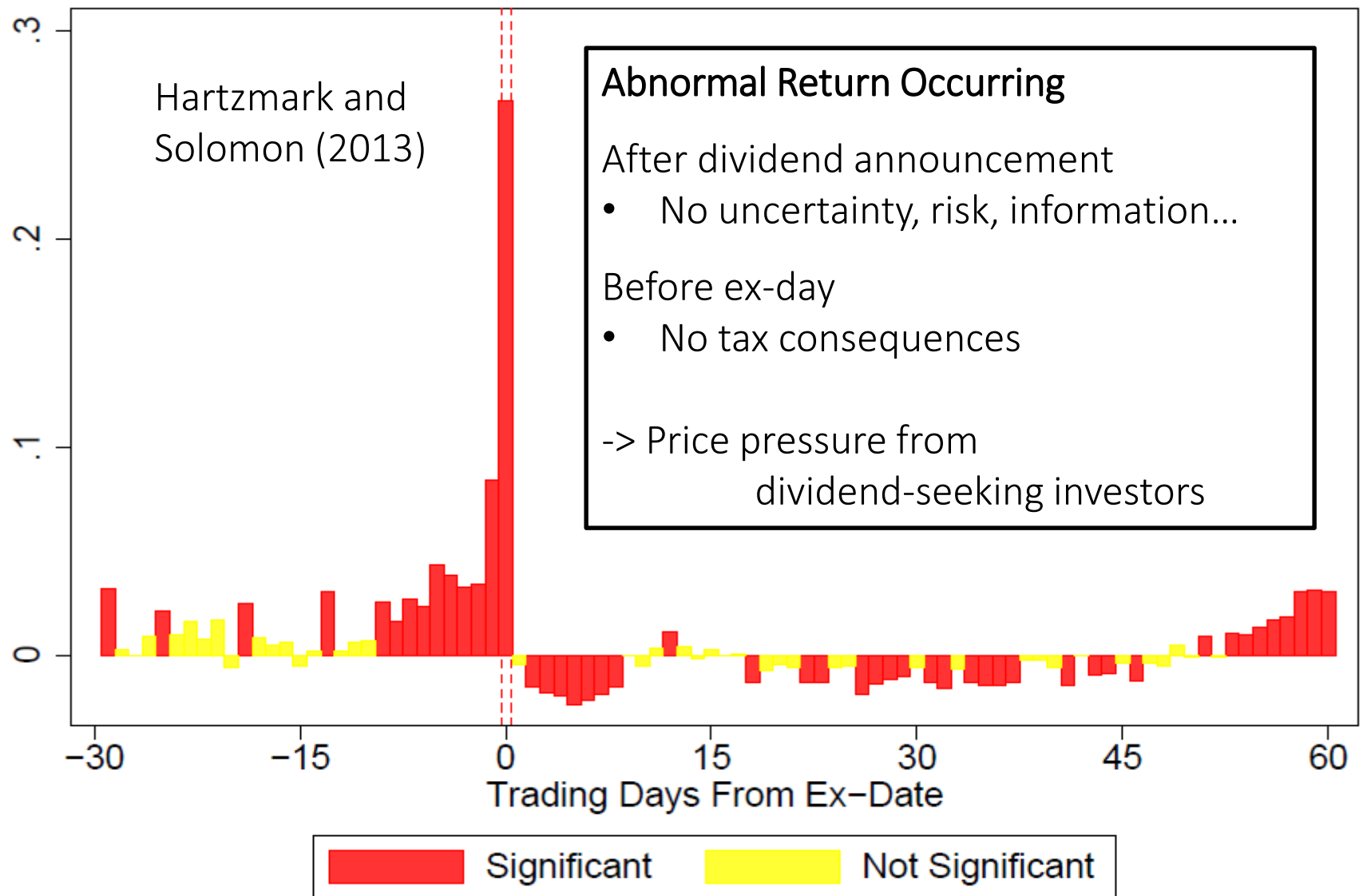




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Theories of Dividend Demand

- Clienteles: “Need for income streams”, elderly. Graham & Kumar (2006)
- Free Dividends Fallacy: Investors think dividends are free money
 - Hartzmark & Solomon (2017)
- Commitment Against Overconsumption
 - Shefrin & Statman (1984), this paper
- Hedonic Editing: Increased prospect theory value by sometimes combining Div + CapGain, sometimes separating them
 - Shefrin & Statman (1984)
- Resolve uncertainty in *how much to consume*
 - View dividends as an annuity

- Demand for dividend-paying assets is higher when interest rates are low
 - Buy more high-dividend stocks when fed funds rate is low
 - Buy more when *local* deposit rate is low
 - Buy more income mutual funds when fed funds rate is low
 - High returns on dividend-paying stocks when fed funds rate is low
- Demand is higher among retirees with greater needs for income
- These actions may be driven by investors following a rule of “live off your income”, including for reasons micro-founded by commitment against overconsumption
 - Consume dividends more when retired

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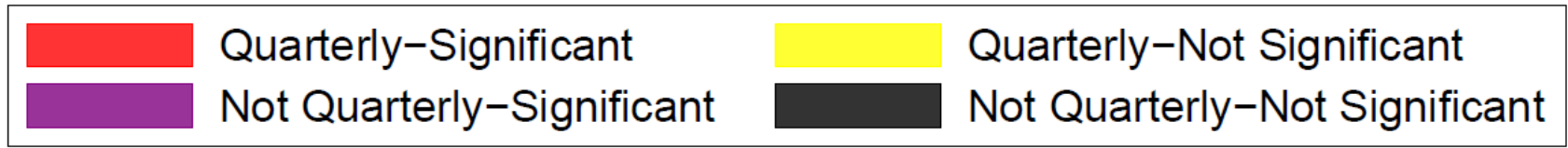
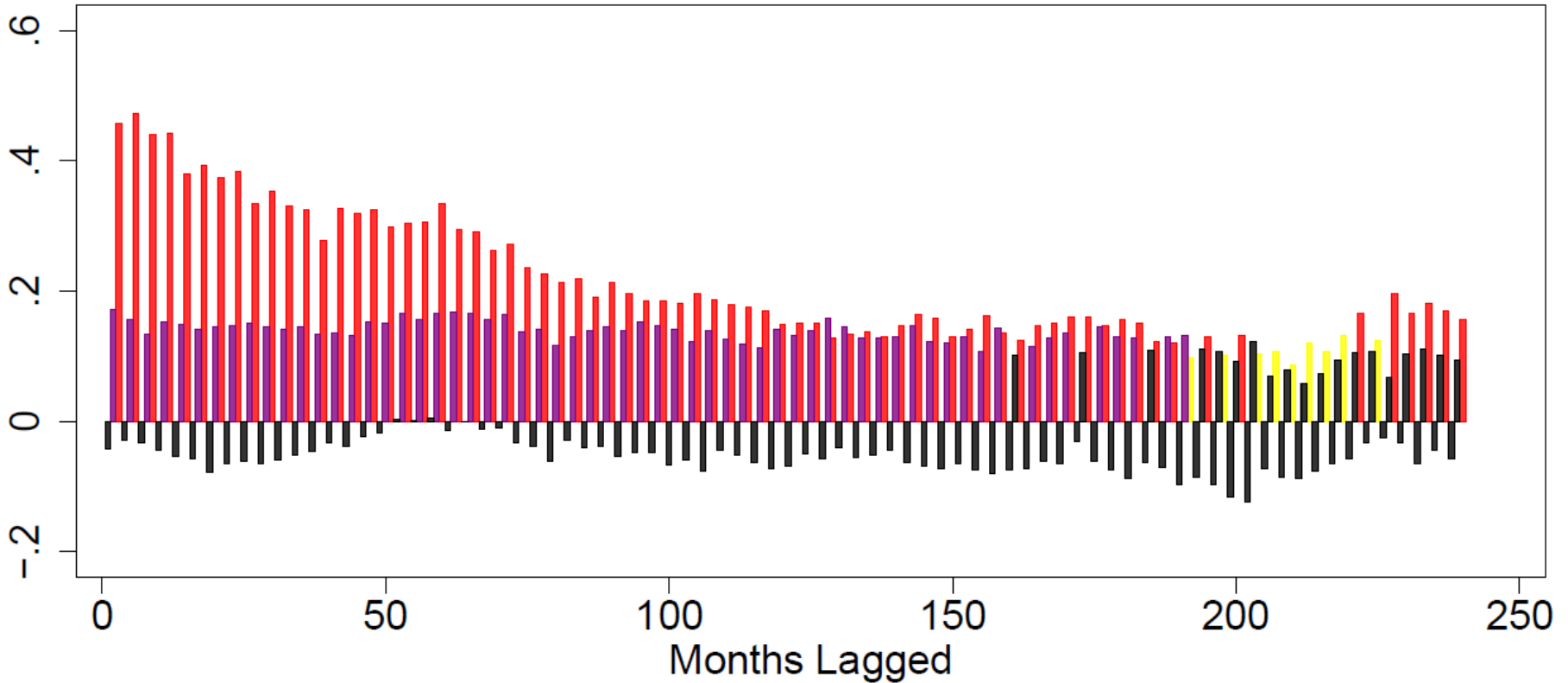
Demand for Dividends & Interest Rates

- Are investors buying and holding dividend-paying assets? Or buying the dividends directly?
- Big predictable time-series effect in returns of dividend-paying stocks
 - High returns *only* in the month the dividend is paid



Demand for Dividends & Interest Rates

Hartzmark & Solomon (2013) Abnormal Returns & Months Since Dividend Payment



Quarterly means the month lag is a multiple of 3.

Demand for Dividends & Interest Rates



Table V - Daily Abnormal Returns, Economic Uncertainty and Dividend Yield

	Recessions				
	Declaration	Interim		Declaration	40 Days
	Day	Period	Ex-Day	to Ex-Day	After Ex-Day
Constant	0.118 *** (21.75)	0.150 *** (8.87)	0.249 *** (37.82)	0.511 *** (27.09)	-0.673 *** (-21.07)
Recessions	-0.013 (-0.80)	0.096 ** (2.08)	0.081 *** (5.51)	0.151 *** (2.99)	-0.282 *** (-3.09)
R ²	0.000	0.000	0.000	0.000	0.000
N	283,166	282,795	284,406	284,406	284,414
	VIX				
	Declaration	Interim		Declaration	40 Days
	Day	Period	Ex-Day	to Ex-Day	After Ex-Day
Constant	0.069 *** (2.65)	-0.372 *** (-4.72)	0.146 *** (5.26)	-0.153 * (-1.79)	0.000 (-0.39)
VIX(/10)	0.012 (0.93)	0.228 *** (5.60)	0.044 *** (3.11)	0.274 *** (6.27)	-0.004 *** (-5.84)
R ²	0.000	0.001	0.000	0.001	0.001
N	136,045	136,003	136,647	136,647	136,632



Demand for Dividends & Interest Rates

- Are investors buying and holding dividend-paying assets? Or buying the dividends directly?
- Big predictable time-series effect in returns of dividend-paying stocks
 - High returns *only* in the month the dividend is paid
- \$64,000 Question: Do you define dividend yields as being positive in *all* months of the year, or only the months with a dividend ex-day?
 - Consumption theory predicts general demand in all months
 - Thinking that dividends are free predicts demand only for the dividend month itself
 - If purchases in all months, shouldn't expected returns at some point be *low*?
- Would love to know what long horizon returns are for a constant portfolio of dividend-paying stocks

When are dividends perceived as more valuable?



But bond yields today are unusually low...

Another strategy would be to substitute a portfolio of blue-chip stocks with generous dividends for an equivalent high-quality U.S. bond portfolio.

Many excellent U.S. common stocks have dividend yields that compare very favorably with the bonds issued by the same companies.



Burton Malkiel

THE WALL STREET JOURNAL.
COMMENTARY
The Bond Buyer's Dilemma



at&t

Dividend Yield: 6%
Bond Yield: <3%



Dividends in the Financial Press

“The humble dividend is reclaiming its rightful place as the arbiter of stock-market value... To investors desperate for income, the argument for buying equities is, well, duh. Who wouldn't want a higher income? Shares might swing around, but corporate managers go out of their way to preserve the dividend.”



By **JAMES MACKINTOSH**
May 9, 2016 10:26 a.m. ET

THE WALL STREET JOURNAL.



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Does any of this even make sense???

- Comparison between dividends and bond interest *isn't comparing the same quantities!*
 - High interest rates at the bank pay you from someone else's pocket
 - High dividend yields pay you *from your own pocket*
- If investors want to commit to just consume a certain amount, why not just buy an annuity?
 - They don't! There's a whole puzzle about this
- If they're just planning consumption, why buy mutual funds who artificially juice their dividend yield by trading in and out of dividend-paying stocks?
 - 28% of dividend-paying funds are doing this!
(Harris, Hartzmark & Solomon (2015))



Even more curious things from financial markets

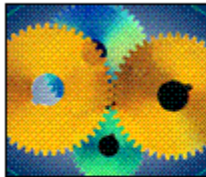


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First Trust Dividend and Income Fund (FAV)

[Fund Summary](#) | [News & Literature](#) | [Historical Pricing](#) | [Distribution History](#) | [Contact Fund](#)



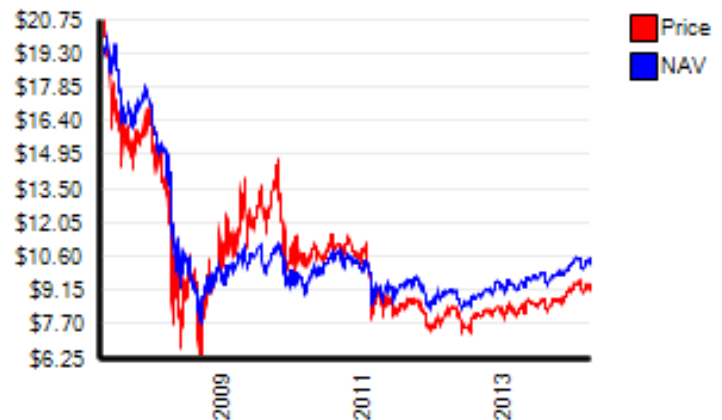
Investment Objective/Strategy - The First Trust Dividend and Income Fund is a diversified, closed-end management investment company. The Fund's primary investment objective is to seek a high level of current income. Its secondary objective is capital appreciation. The Fund will seek to achieve its investment objectives by investing at least 80% of its managed assets in a diversified portfolio of dividend paying multi-cap equity securities, debt securities and senior secured floating rate loans that offer the potential for attractive income and/or capital appreciation.

There can be no assurance that the Fund's investment objectives will be achieved.

Current Fund Data (as of 9/8/2014)

Closing NAV ¹	\$10.35
Closing Share Price ²	\$9.30
Discount to NAV	10.14%
Total Managed Assets	\$109,498,265
Common Shares Outstanding	8,259,517
Dividend Frequency	Quarterly
Dividend Per Share Amt ³	\$0.1700
Distribution Rate ⁴	7.31%
Daily Volume	44,882
Average 30-Day Daily Volume	37,489
Closing Share Price 52-Week High/Low	\$9.57 / \$8.16
Closing NAV 52-Week High/Low	\$10.56 / \$9.25

Share Price and NAV History (Since Inception)



Past performance is not indicative of future results.



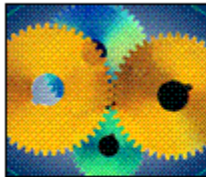
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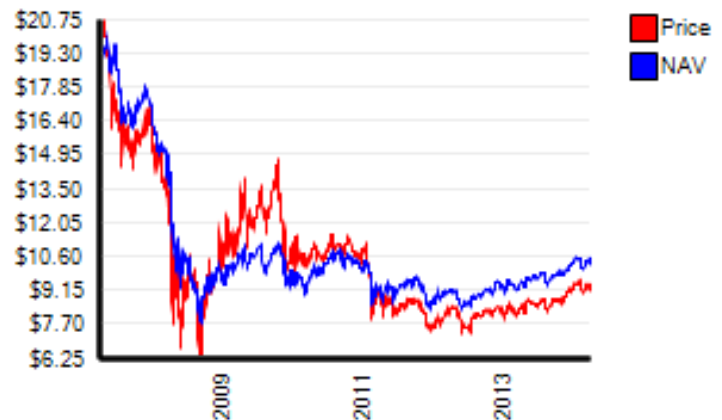
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Descending down the rabbit hole

<http://www.sec.gov/Archives/edgar/data/1403275/000144554609000266/0001445546-09-000266.txt>

First Trust Active Dividend Income Fund
Financial Highlights
For a Common Share outstanding throughout each period



First Trust Dividend and Income Fund (FAV)

	Year Ended 11/30/2009	Year Ended 11/30/2008	Period Ended 11/30/2007
Ratios to average net assets/supplemental data:			
Net assets, end of period (in 000's).....	76,196	76,456	137,117
Ratio of total expenses to average net assets.....	1.89%	1.31%	1.44%
Ratio of net investment income to average net assets.	19.31%	11.34%	13.87%
Portfolio turnover rate.....	2,030%	1,722%	178%



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- How do you get a dividend yield of 19.31%?!?!

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Huntington Dividend Capture Fund

Share Classes

PORTFOLIO PROFILE

As of 8/31/2014

Inception	03/01/2001
Ticker	HDCAX
CUSIP	446327660
Net Assets (millions)	\$67.39

Fund Goal And Strategy

To seek total return on investment, with dividend income as an important component of that return. The Fund is appropriate for investors seeking capital appreciation with the potential for higher current income than the average stock fund.

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“May increase portfolio turnover”

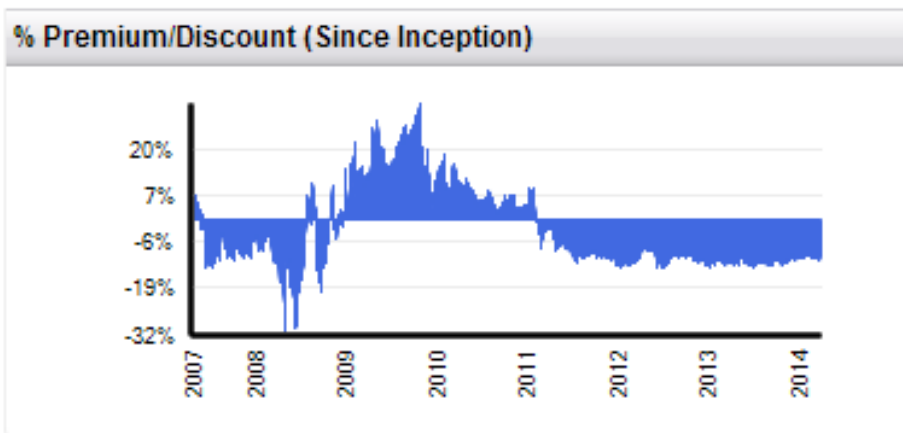
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- Surely nobody is actually buying this fund, right?

Reaching Rock Bottom

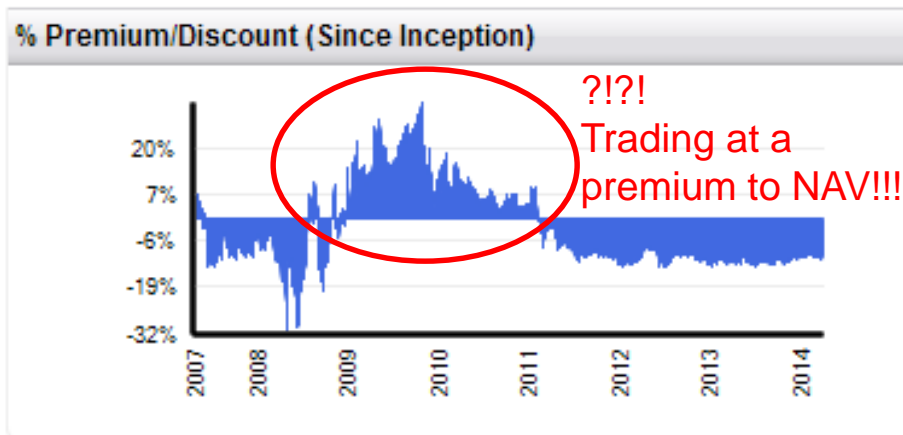
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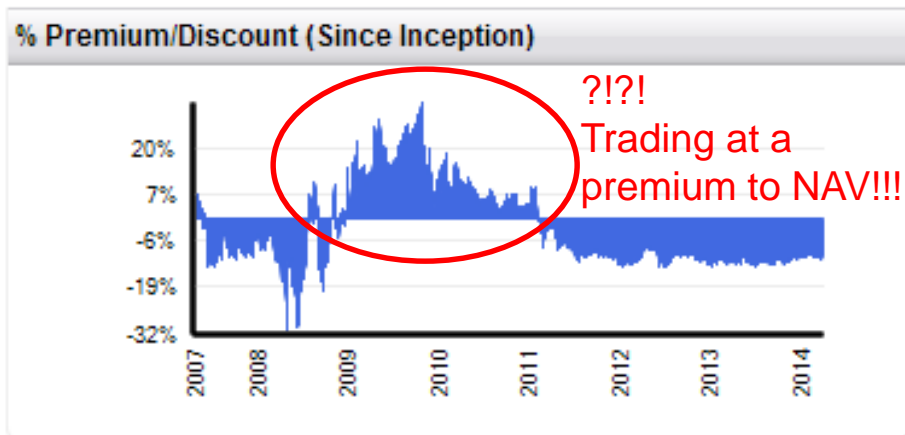
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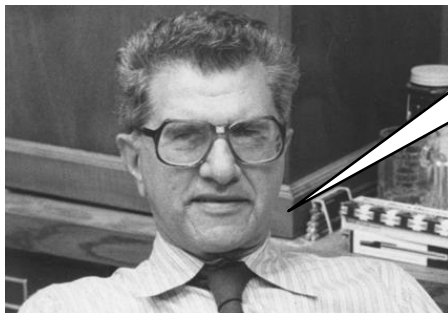
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Did you muppets not learn anything?



All this rolling in my grave is making me nauseous



Conclusion



- Interesting evidence that demand for dividends is higher in low interest rate environments
- Consistent with financing consumption streams, but also consistent with other mistakes too
- Best evidence: Retirees demanding high dividend stocks, Retirees consuming dividends
- Probably both explanations. Hard to tell apart, and other papers don't do a much better job