November 2024

Not Diversification, Dividendifcation!

CRAWFORD
INVESTMENT COUNSEL
Est. 1980

Diversification: *Owning a wide variety of investments with different characteristics to reduce risk.*

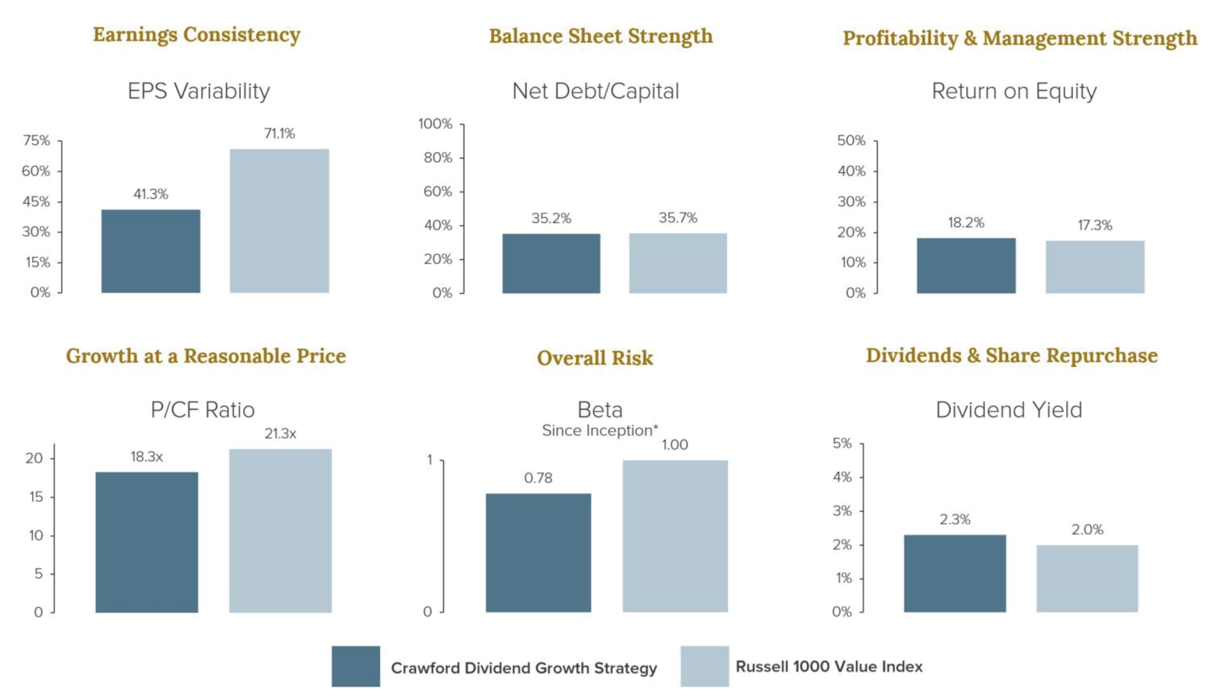
Dividendification: *Owning only the highest-quality investments with the best likelihood of success to earn superior returns and reduce risk (at the same time). Also, experience rising portfolio income over time to consistently enhance purchasing power.*

Many investors today embrace diversification to the point that, in some cases, it is referred to as an investment philosophy. To be clear, diversification is an element of a strategy, not a philosophy. In many cases, we observe portfolios that are overdiversified. The mantra goes something like this: own the entire world and you will end up with non-correlated assets, some will do well and others will not, but they will cancel each other out and lead to less volatile returns. In reality, the pattern of returns for a diversified portfolio may very well be less volatile, but the portfolio almost certainly will experience more pedestrian returns because it owns a number of substandard investment allocations that often carry higher fees. Also, if the allocations are spread over a very wide range of investments, many of them are likely to actually be correlated in periods of market and economic stress.

On the contrary, at Crawford, we practice what we call dividendification. This is a philosophy anchored around the link between dividends and quality, the importance of income to investor outcomes and portfolio returns, the knowledge that adequate diversification and downside protection can be accomplished with a more concentrated portfolio, and a commitment to owning only what we believe are the strongest companies trading at attractive valuations. Our experience teaches us that dividendification has beaten over-diversification consistently on both a return and risk basis. Thus, we practice dividendification and focus portfolios on the critical success factor that drives returns and controls risk: quality.

Quality is a differentiated and unique investment characteristic because it positively influences both risk and return. Quality can manifest in many ways, but typically this factor enables investors to participate in up markets and protect in down markets. This leads to lower downside capture and strong returns over a full market cycle. Because dividends and quality are linked, quality also typically leads to higher levels of portfolio income year in and year out.

Crawford has a long-held belief that dividends are an excellent marker of quality. In fact, we believe dividends and quality are inexorably linked. A company’s ability to consistently pay, and increase, its dividend is an indicator of underlying strength. This relates to the fact that dividend-paying companies typically have more consistent earnings, strong balance sheets, and high returns on equity and assets, all of which contribute to a lower-volatility, higher-quality investment profile. The income from dividends is also a powerful component of total investment return.



Source: Crawford, FactSet (Data as of 9/30/2024) *Beta is calculated since the strategy's inception date of 1/1/1981.

In summary, instead of populating portfolios with a broad variety of investments, Crawford invests in only what we believe are the highest-quality securities with the best return profile compared to risk. This places clients on the steepest part of the return/risk continuum which leads to low beta and positive risk-adjusted returns (alpha) over time. We seek diversification by investing across various areas and sectors of the market, and we insist on dividendification in the name of achieving successful outcomes for our clients.