Episode 74

Fourth Quarter 2018 Review of the Global Dividend Yield Portfolio

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Jordan: Hello, this is Jordan Greenhouse, Client Portfolio Manager with Kayne Anderson Rudnick. Along with me today I have Richard Sherry, Senior Portfolio Manager of the Kayne Anderson Rudnick Global Dividend Yield portfolio. Rich, thanks for setting aside the time today to review 2018. During the 4th quarter of 2018, we noticed a substantial uptick in overall volatility within the equity marketplace. Can you provide us performance information for the portfolio during the quarter as well as year-to-date performance?

Rich: Hi Jordan. Yes. We actually first noticed an uptick in volatility in September. Markets had been very strong over the summer but by September investors were starting to become concerned about the impact of trade wars and a potential weakening in the global economy. However, interest rates were still continuing to move higher. Then in early October Fed Chairman Powell noted that interest rates were a long way from neutral. Investors disagreed with that assessment and sent stock prices and interest rates lower.

In this type of environment investors tend to seek solace in the stable businesses that make up the majority of the stocks that we own in the portfolio. The portfolio declined by mid-single digits during the quarter and for the full year. This was a few percentage points better than our high dividend yield benchmark. Broad indices on the other hand declined by mid-double digits during the quarter and finished the year down mid-to high-single digits.

Jordan: Within your strategy, what were some of the key attributors to the portfolio and can you walk us through an example of one of those names?

Rich: As one might expect, our best performing stocks during the quarter were those that provide basic products and services that are less sensitive to economic activity and those companies that have a significant amount of their business that renews each year. Think utilities, food & beverage companies and healthcare for the former and food service and waste management companies for the latter. These kind of stocks have always represented a large percentage of the stocks in this portfolio and are generally the best performing stocks when investors become concerned about a slowdown in the economy.

Among the former, that would include Fortis, which is a Canadian-based utility which operates in both Canada and the United States. The vast majority of its business is related to the transmission and distribution of electricity. This business tends to be less volatile than the actual generation of electricity, yet is still underpinned by the stable dynamics related to electricity usage, which is not very exposed to swings in economic activity. Consumers and businesses tend to continue to turn on the lights regardless of short-term swings in the economy. As a result this stock was one of our best-performing stocks during the quarter, increasing at a low-to mid-single digit rate. This "steady eddie" company has increased its dividend every year since 1973 and is on track to grow it at a mid-single digit rate over the next several years.

Jordan: Richard, additionally, can you walk us through an example of a portfolio detractor during the quarter?

Rich: As one might expect it was the stocks that are most economically sensitive that were the weakest performing stocks in the quarter. One example of that is ABB, which is a Swiss-based industrial company. ABB produces products and provides services which are involved in electrification, industrial automation and robotics & motion. It is one of only a handful of industrial companies that did not have to cut its dividend during the financial crisis.

We believe that the company is well-positioned for the long-term and is on the right side of some secular tailwinds. In addition, its services and software offerings continue to make up a larger part of its business. These offerings are much more stable than product sales and contribute to a more stable earnings profile. However, the company does remain exposed to a slowdown in order activity if economic growth slows and this had a negative impact on the stock during the quarter.

Jordan: Has the recent market volatility provided you and your team with any opportunities to add to new investments within the portfolio and can you provide us an example of one of these?

Rich: Sure. We don't do too much trading in the portfolio, but we have picked up a few names and added to some existing names over the past few months.

One of the new names that we've purchased recently is Tate & Lyle. Tate & Lyle is a UK-based provider of ingredients and solutions to the food & beverage industry. The company has a particular strength in sweeteners and starches. It uses its knowledge and manufacturing capabilities to help its customers improve the texture and functionality of food and drink products. For example, it helps yogurt makers produce new products that are not only flavorful and tasty but benefit from reduced sugar, fat and calories. The company also has a strong position in industrial starches, where its products are used in cosmetics, detergents, carpets and textiles. The business produces strong, steady cash flow and pays a nice, consistent dividend.

Jordan: Richard, the last question I have is, as we're approaching the ten-year period into this bull market cycle, when looking at your portfolio and Kayne's overall investment approach with a focus on quality, are there any factors that you and your team are more focused on moving forward into 2019 and beyond?

Rich: The factors that we focus on remain the same and haven't really changed. We continue to look for high-quality businesses that produce strong cash flow, have solid investment-grade balance sheets and return a significant portion of the excess capital that the business generates to shareholders via dividends. Our sweet spot remains investing in slower-growing mature businesses that tend to have a "sticky" revenue base that carries over from year-to-year and is less exposed to economic volatility and business disruption. Despite the ten-year bull market, we continue to find the kind of businesses that meet our investment criteria and are still priced such that we receive a good dividend yield from that investment.

Yes, we've have had to sell some stocks over the past several years that had appreciated to the point that they no longer offered an attractive dividend yield (not necessarily a bad thing). But we continue to find solid replacements for those stocks with companies that are of equal or better quality and offer attractive yields. Thanks Jordan.