



# NORTH STAR

Investment Management

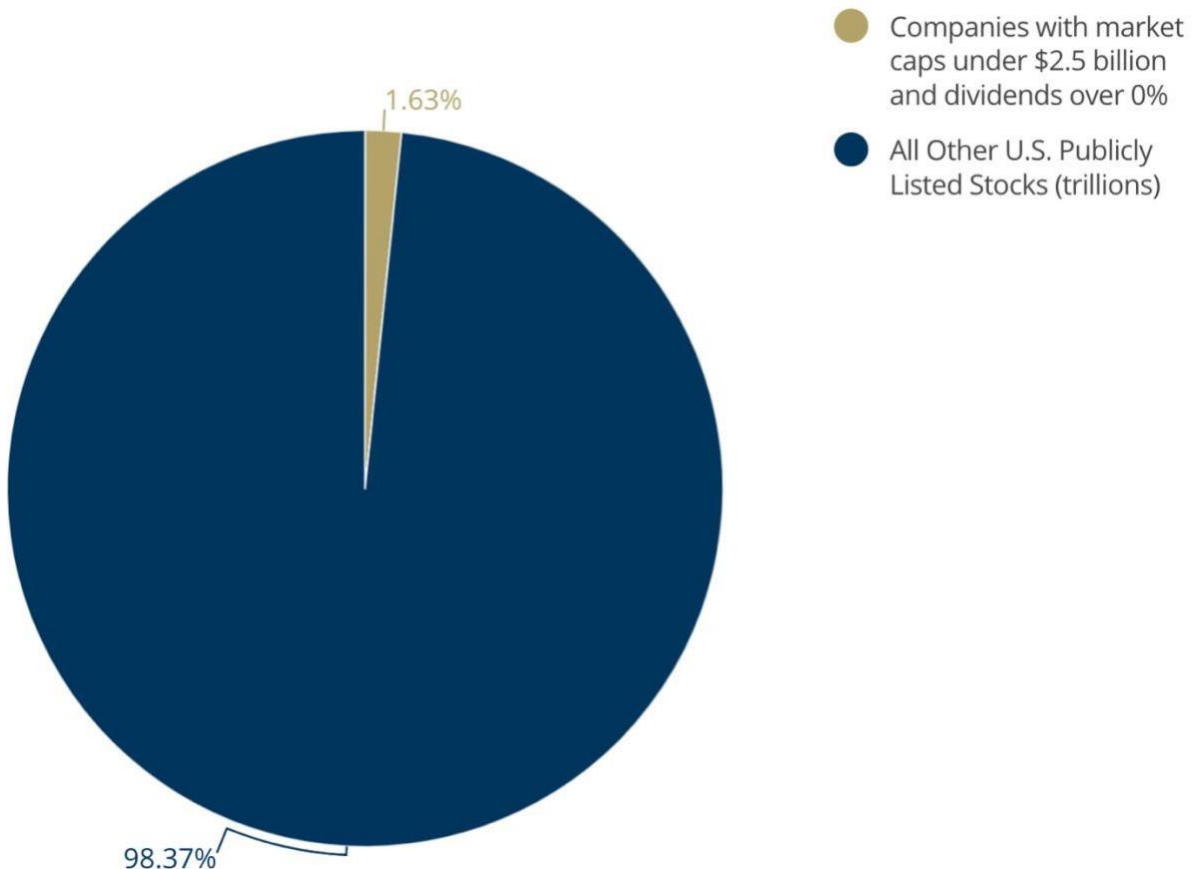
## The Case for Small Cap Dividend Paying Securities in a Portfolio

By: Eric Kubby, Chief Investment Officer

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North Star Investment Management believes that small cap dividend paying stocks offer both a stable income flow and the potential for appreciation. Despite historically superior long-term returns, investors typically underweight small cap dividend paying companies in their portfolios. For the purposes of this discussion, small cap dividend stocks are defined as companies with less than \$2.5 billion that pay a dividend. Whereas 53.7% of all dividend-paying companies are small caps the total value of small cap dividend stocks is only \$671 billion, less than 2% of the total value of publicly traded U.S. companies. In fact, five individual companies – AAPL, MSFT, GOOGL, AMZN, and FB – all have market caps that exceed that of the entire universe of small cap dividend paying companies.

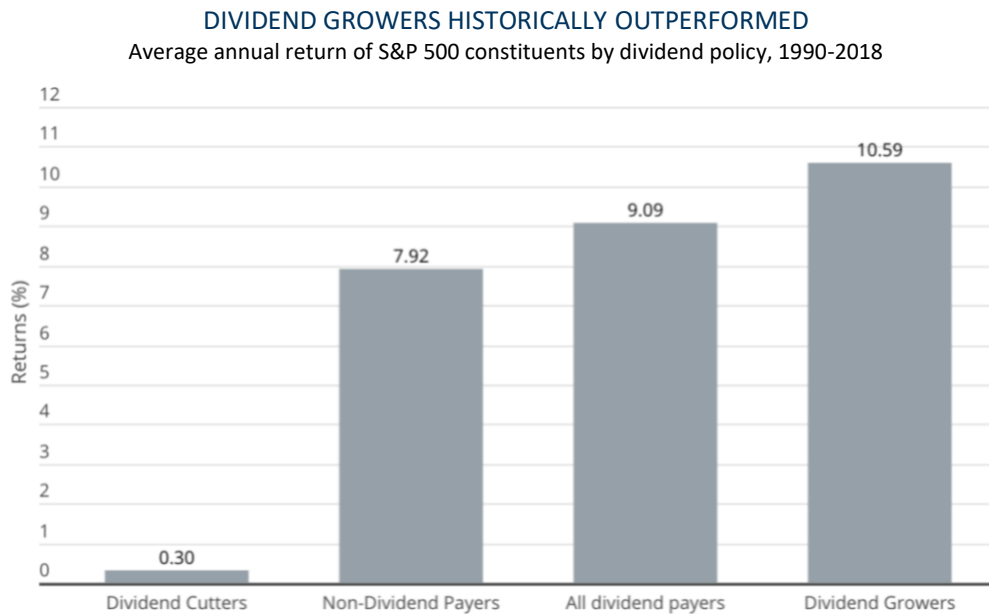
### SMALL CAP DIVIDEND PAYERS AS A PERCENT OF US TOTAL MARKET CAPITALIZATION



Source: FactSet

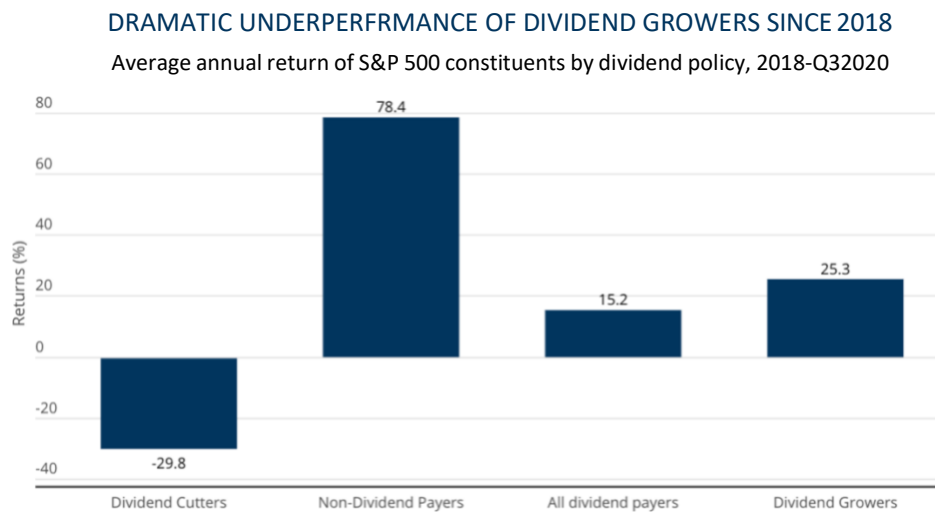
### The Case for Dividend Payers

With the stock market indices at near record highs and bond yields at historic lows, we think this asset class represents a timely investment opportunity. As the below chart illustrates, over the long run, dividend paying stocks have historically provided a return greater than non-dividend paying stocks. Whereas share prices fluctuate, dividends still provide positive returns even during periods of market declines.



Source: FactSet

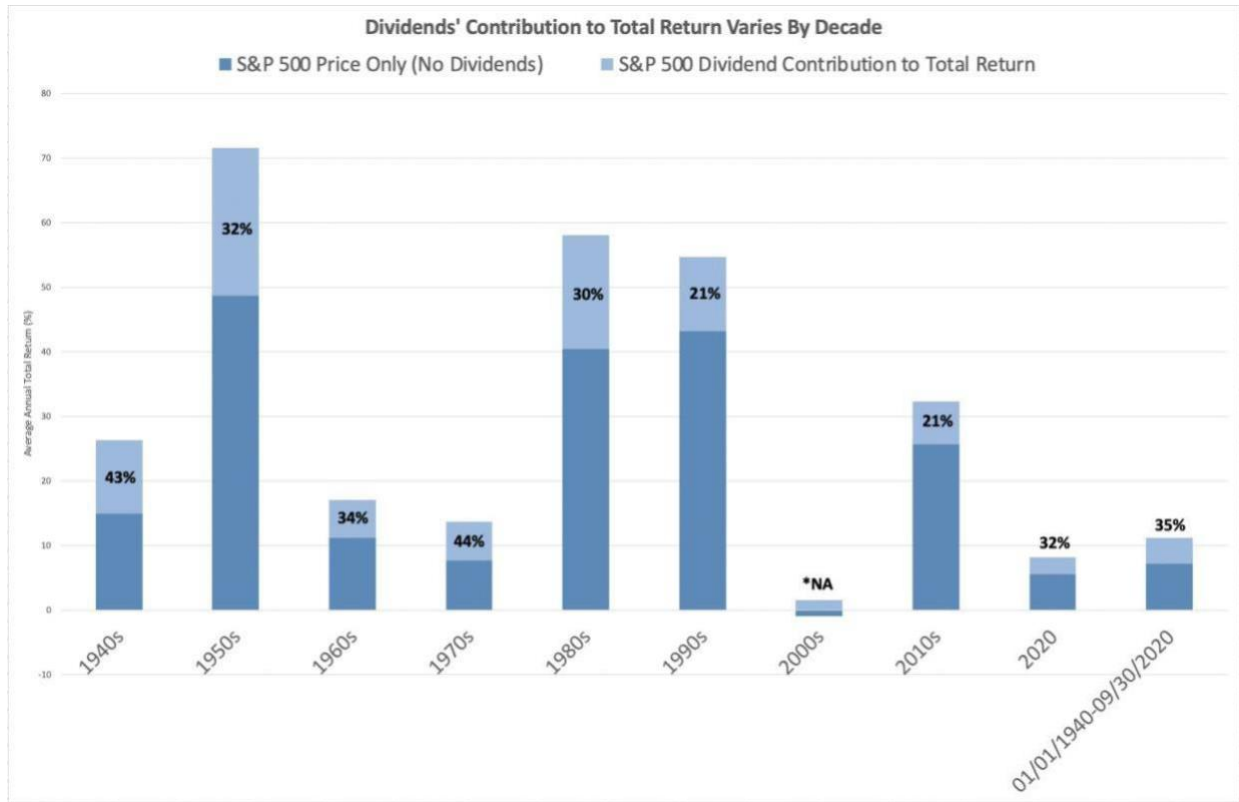
As the next chart shows, inconsistent with the long-term trends, dividend paying stocks have dramatically underperformed dividend-paying stocks over the last 21 months.



Source: FactSet

## Contribution of Dividends to Total Stock Market Returns

Dividend paying stocks can provide a return component less volatile than the capital appreciation component. Share price returns alone can be negative and quite volatile, but historically dividends have provided positive equity return contributions, which is particularly important during periods of weak price appreciation in the broad market. It is worth noting over the last eight decades dividends have generated over 35% of total return.



Data Source: Bloomberg as of 09.30.2020

\*Total Return for the S&P500 Index was negative for the 2000s. Dividends provided a 1.5% annualized return over the decade.

Past performance is no guarantee of future results.

The S&P500 Index is an unmanaged market-capitalization-weighted index generally considered to be representative of U.S. equity market activity. The index consists of 500 stocks representing leading industries of the U.S. economy. Index results assume the reinvestment of dividends paid on the stocks constituting the index. Indexes are unmanaged and not available for direct investment and do not represent the performance of a single fund

As the chart above shows, the dividend income (light blue) is relatively predictable, whereas the price appreciation (darker blue) is quite volatile. That lower volatility may be particularly important for investors who rely on their portfolios to fund their living expenses or retirement, as it would be unfortunate to need to sell stocks to raise cash in order to pay expenses when share prices are low.

### **High Quality Small Cap...Even Better**

Most dividend strategies limit their scope to large cap companies, but an even greater percentage of small cap dividend paying stocks have healthy dividends over 3%. Whereas we earlier indicated that 53.7% of all dividend paying stocks are small caps, 64% of stocks with a 3% yield or higher have market caps under \$2.5 billion. Those small cap companies have also generated superior investment returns in most time periods but have dramatically underperformed over the last two years.<sup>1</sup> As a result, we think the current valuations of small cap value companies present attractive opportunities.

### **Why Our Formula Matters Now**

We stick to a few basic principles that have driven long-term performance in our dividend strategy. Given the current relatively high valuation of the overall market and the historically low level of bond yields, we think this strategy is particularly timely. We seek the under-researched, smaller companies who support long-term dividend payments with growth potential, management teams who interest align with shareholders, and business models that have historically generated high returns on equity. We believe these characteristics combine to provide a more stable return particularly in periods of higher volatility and lower overall market returns. In conclusion, we believe that small cap dividend paying stocks currently offer an extraordinary opportunity and we seek out the best companies within this sector.

*The North Star Dividend Fund (NSDVX) is one of the few mutual funds that focuses on small cap dividend paying stocks. For more information, please contact us at [bkuby@nsinvest.com](mailto:bkuby@nsinvest.com) or 312-580-0900*

### **Important Risk Information:**

The indices shown are for informational purposes only and are not reflective of any investment. As it is not possible to invest in the indices, the data shown does not reflect or compare features of an actual investment, such as its objectives, costs and expenses, liquidity, safety, guarantees or insurance, fluctuation of principal or return, or tax features.

Mutual Funds have investment risks including loss of principal. There is no guarantee the fund will meet its objective. In general, the price of a fixed income security falls when interest rates rise. There is a risk that issuers and counterparties will not make payments on securities and other investments held by the Fund, resulting in losses to the Fund. The Fund may invest in high yield securities, also known as “junk bonds”. High yield securities provide greater income and opportunity for gain but entail greater risk of loss of principal. Foreign common stocks and currency strategies will subject the Fund to currency trading risks that include market risk, credit risk and country risk. Municipal securities are subject to credit risk where a municipal security might not make interest and principal payments as they come due. The Advisor follows an investing style that favors value investments. At times when the value investing style is out of favor, the Fund may underperform other funds that use different investing styles. Investments in lesser known, small and medium capitalization companies may be more vulnerable than larger, more established organizations. As with any investment, there are risks associated with REITs. Investments in lesser-known, small and medium capitalization companies may be more vulnerable than larger, more established organizations. The Advisor does not attempt to keep the portfolio structure or fund performance consistent with any market index. Increased portfolio turnover may result in higher brokerage commissions, and other transaction costs may result in taxable capital gains.

**Investors should carefully consider the investment objectives, risks, charges and expenses of the North Star Funds. No-Load Mutual funds are sold without sales charge; however, they have ongoing expenses, such as management fees. This and other important information about each of the Funds are contained in the prospectus, which can be obtained at [www.nsinvestfunds.com](http://www.nsinvestfunds.com) or by calling (855)580-0900. The prospectus should be read carefully before investing. The North Star Funds are distributed by Northern Lights Distributors, LLC member FINRA/SIPC. North Star is not affiliated with Northern Lights Distributors, LLC.**  
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<sup>i</sup> Banz, Rolf W. “The relationship between return and market value of common stocks.” Journal of Financial Economics 9: 3-18.