

Q WEALTH ASSET MANAGEMENT
FOUNDATION SERIES

BEYOND YIELD:
**AN INSTITUTIONAL
FRAMEWORK FOR
DIVIDEND INVESTING**

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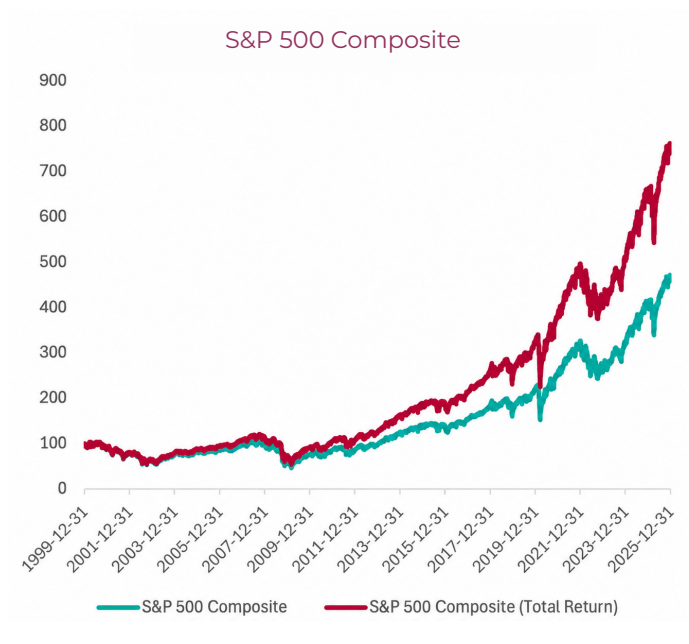
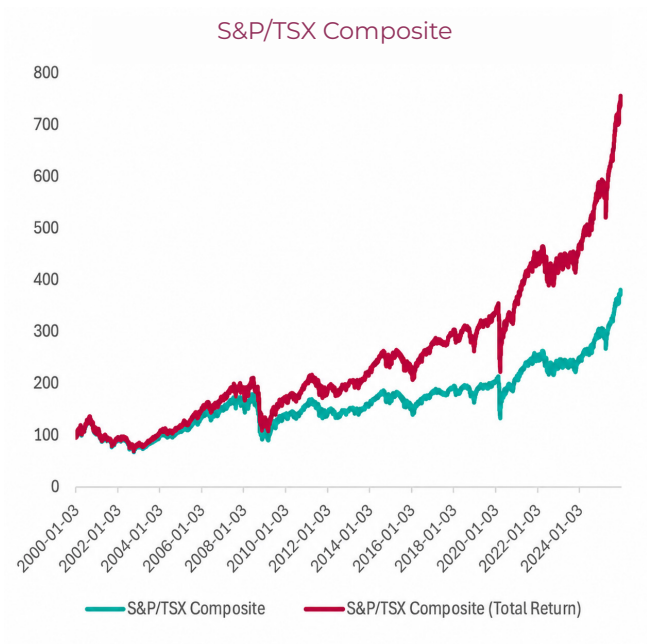
THE IMPORTANCE OF DIVIDENDS IN EQUITY INVESTING

Dividends have historically represented a significant component of long-term equity returns, not merely as income, but as a key driver of compounded total return. Academic research has long highlighted the importance of dividends in explaining equity market performance, with early work by Eugene F. Fama and Kenneth R. French¹ demonstrating that dividend yields contain meaningful information about expected returns and long-term market behaviour.

While investors often focus on price appreciation, equity markets historically derive a meaningful portion of their long-term performance from dividends and their reinvestment. This distinction becomes especially important in portfolio construction, where total return (rather than price movement alone) ultimately determines investor outcomes.

The data below compares price returns and total returns for Canadian and U.S. equities over the long term. The difference between these two measures reflects the contribution of dividends to compounded portfolio growth.

Price Return vs Total Return — Dividend Contribution



Source: Bloomberg, Q Wealth Partners (From January 1, 2000 to December 31, 2025)



WHY THE DIFFERENCE MATTERS

The table below highlights the significant gap between price-only performance and total return outcomes. Over multi-decade horizons, dividends materially enhance investor results, adding nearly 3% annualized in Canada and roughly 2% annualized in the United States over this period.

The Importance of Dividends in Equity Investing

Index	Price Return	Total Return	Return Difference	Price Return (Annualized)	Total Return (Annualized)	Total Return (Annualized)
S&P/TSX Composite	276.90%	642.19%	+365.29%	5.24%	8.01%	+2.77%
S&P 500 Composite	365.92%	651.78%	+285.86%	6.10%	8.06%	+1.96%

Source: Bloomberg. Total return assumes reinvestment of dividends. (Dec 31, 1999 – Dec 31, 2025 in Local Currency)

This difference compounds exponentially over time. While price appreciation drives headlines, the reinvestment of dividends quietly contributes a substantial portion of long-term wealth creation, reinforcing why institutional portfolio construction focuses on total return rather than price performance alone.

Over long horizons, dividends contribute to performance in two key ways:

1. Income Contribution

Dividends provide a direct return stream independent of market price movements. In markets such as Canada, where sectors like financials, energy, and utilities dominate, this income component has historically represented a meaningful share of total returns.

2. Compounding Through Reinvestment

Perhaps more importantly, reinvesting dividends allows investors to benefit from compounding. Each reinvested payment increases the base of invested capital, which in turn generates additional future income and growth.

Over decades, this compounding effect can dramatically widen the gap between price returns and total returns, as seen in both Canadian and U.S. equity markets.



AN INSTITUTIONAL PERSPECTIVE

Institutional investors rarely evaluate equities based solely on price appreciation. Pension plans, endowments, and sovereign funds focus on total return, recognizing that dividend income can:

- Reduce reliance on capital gains alone.
- Improve portfolio resilience across market cycles.
- Provide a natural rebalancing mechanism through reinvestment.

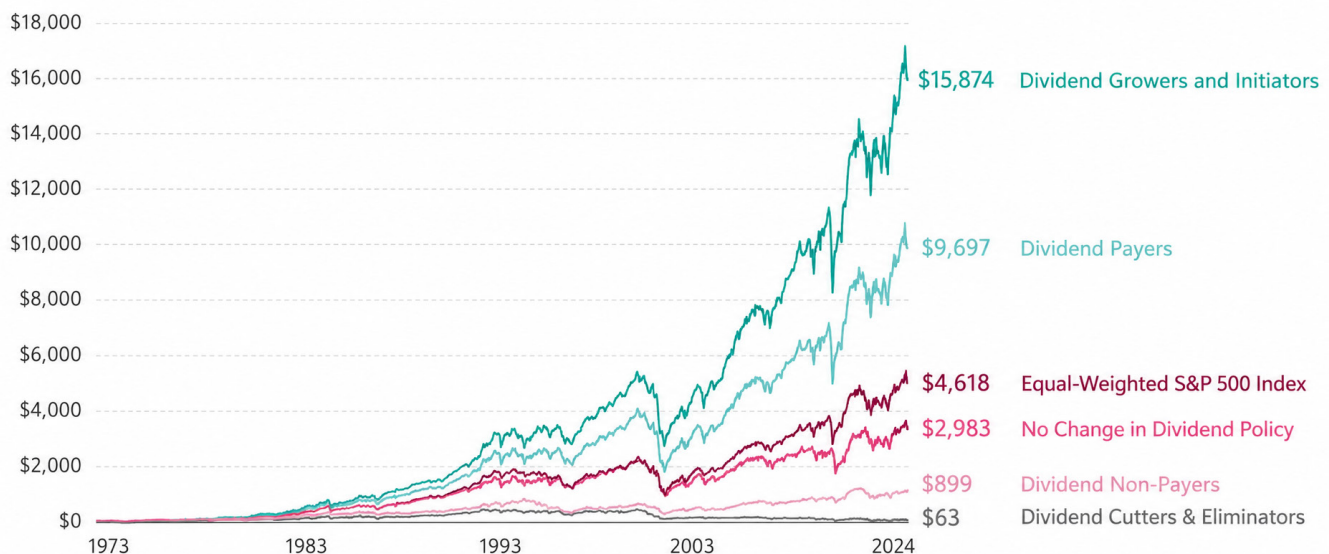
In Canada specifically, dividends have historically been an integral part of equity investing, reflecting the market's composition of mature, cash-flow-generating companies.

Not All Dividends Are Created Equal

While dividends have historically played a significant role in total equity returns, it is important to recognize that not all dividend-paying companies deliver the same investment outcomes. The quality and trajectory of a company's dividend policy can provide valuable insight into its financial strength, earnings durability, and long-term growth potential.

As illustrated in the chart below, companies classified as "Dividend Growers and Initiators" have significantly outperformed both the broader market and other dividend categories over time. In contrast, firms that maintain flat dividend policies, or worse, cut or eliminate dividends, have historically lagged. This pattern has been well documented in studies from Ned Davis Research, which shows that dividend growth and initiation have historically been associated with stronger long-term equity performance, while dividend cutters and eliminators have tended to underperform.²

Dividend Policy Matters: Evidence from Long-Term Market Data



Source: Ned Davis Research as of 12/31/24. Past performance does not guarantee future results. For illustrative purposes only.

DIVIDEND POLICY AS A SIGNAL OF FINANCIAL STRENGTH

Dividends can act as a barometer of corporate health. Companies with stable and growing earnings streams are often able to increase their dividend payouts over time, reflecting confidence in future cash flows and balance sheet resilience.

Unlike bond coupon payments, however, dividends are discretionary. Corporate boards retain the flexibility to reduce or suspend distributions during periods of stress. As a result, changes in dividend policy can provide meaningful information about underlying fundamentals:

Dividend Decisions Reflect Corporate Fundamentals



■ Dividend Growers and Initiators

Typically demonstrate improving earnings power, disciplined capital allocation, and stronger balance sheets. These firms often exhibit characteristics associated with quality and profitability factors.

■ Stable Dividend Payers

Companies that maintain flat payouts may offer income stability, but without earnings growth, long-term capital appreciation may be more limited.

■ Dividend Cutters and Eliminators

Historically among the weakest performers. Dividend reductions frequently occur alongside deteriorating fundamentals, rising leverage, or cyclical pressure.

BEYOND YIELD: A DISCIPLINED INSTITUTIONAL FRAMEWORK FOR DIVIDEND INVESTING

Institutional investors increasingly view dividend strategies not simply as income vehicles, but as a form of **factor exposure**, particularly to quality, value, and low-volatility characteristics.

Focusing solely on yield can lead to unintended risks, including:

- Exposure to structurally challenged sectors.
- Elevated leverage or payout ratios.
- "Yield traps" where high dividends mask weakening fundamentals.

Instead, an evidence-based dividend framework emphasizes:

- Sustainable earnings growth.
- Strong free cash flow generation.
- Balance sheet discipline.
- Consistent dividend growth over time.

In this context, dividend growth, rather than dividend level alone, becomes a more reliable indicator of long-term equity performance.

Beware of Yield Traps

While dividend growth has historically been associated with stronger long-term performance, relying on dividend increases alone is not sufficient. There are periods when companies maintain, or even raise, dividends despite weakening underlying fundamentals. These situations are commonly referred to as "yield traps."

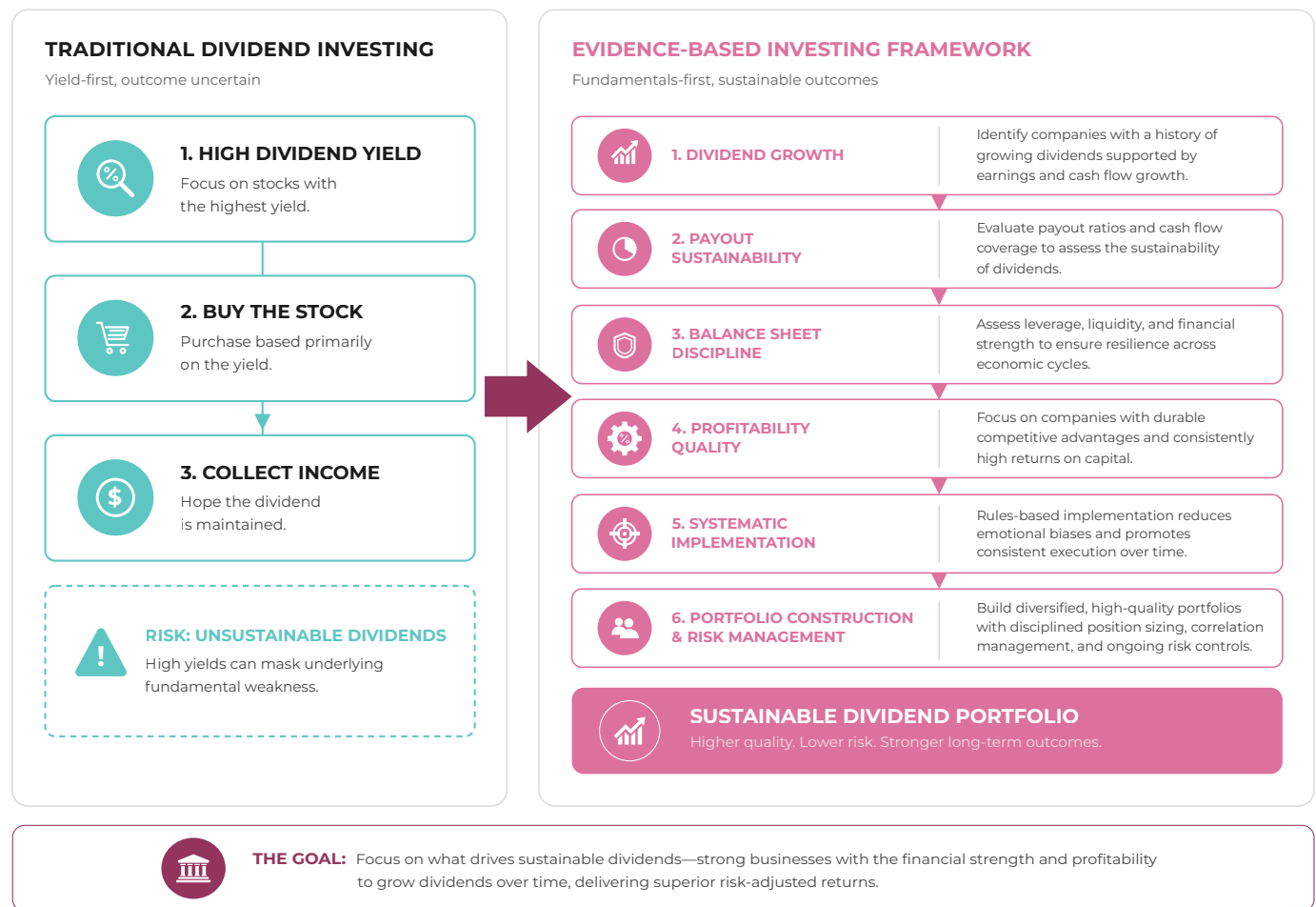
Yield traps occur when elevated dividend yields attract investors, even as a company's earnings power and cash generation begin to deteriorate. In some cases, firms may prioritize maintaining dividends to support investor confidence or stabilize share prices, masking underlying structural challenges within the business.

Over time, however, dividends that are not supported by sustainable operating performance can become increasingly difficult to maintain.

BEYOND YIELD: A DISCIPLINED INSTITUTIONAL FRAMEWORK FOR DIVIDEND INVESTING

Evidence-Based Investing Framework

Moving beyond yield to build sustainable, compounding dividend portfolios.



LOOKING BEYOND HEADLINE YIELD

Avoiding potential yield traps requires a deeper evaluation of the sustainability of dividend payments. Rather than focusing solely on dividend growth or yield levels, investors should assess the underlying financial drivers that support distributions. Academic research has shown that elevated dividend yields alone may increase the risk of so-called “dividend traps” when not supported by sustainable payout ratios and operating fundamentals.³ This reinforces the importance of incorporating cash flow stability, payout discipline, and earnings durability into a comprehensive dividend framework.

Key areas of focus include:

1. Dividend Payout Ratios

Payout ratios provide insight into how much of a company’s available cash flow is being distributed to shareholders. Conservative payout levels, particularly when measured against free cash flow from operations, help create a margin of safety and allow dividends to remain sustainable across market cycles.

Elevated payout ratios, by contrast, may indicate limited flexibility if earnings weaken or operating conditions deteriorate.

2. Declining Earnings and Cash Flow

Sustainable dividends ultimately depend on consistent earnings generation and strong operating cash flows. When revenue growth slows or margins compress, companies may face increasing pressure to fund dividends from shrinking cash resources.

Persistent declines in earnings or free cash flow can signal that current dividend policies may not be sustainable over the long term.

3. Structural Business Challenges

Industries undergoing disruption, declining demand, or cyclical headwinds may struggle to maintain dividend growth despite maintaining high yields in the short term. Structural challenges such as technological disruption, regulatory changes, or shifting commodity cycles can weaken the underlying economics of a business, increasing the risk that dividends become vulnerable over time.



A MORE DISCIPLINED APPROACH TO DIVIDEND INVESTING

An evidence-based dividend framework emphasizes sustainability over yield. By screening for conservative payout ratios, stable cash flow generation, and resilient business models, investors can reduce exposure to potential yield traps and improve the overall quality of dividend-focused portfolios.

Debt, Leverage, and Dividend Sustainability

In addition to evaluating payout ratios and cash flow trends, investors must consider what can potentially stand in the way of future dividend payments. While dividends are an important component of total return, they sit lower in a company's capital structure compared to debt obligations.

Companies often scale their operations through borrowing and financial leverage. Interest payments on debt are contractual obligations and must be serviced regardless of economic conditions, whereas dividends remain discretionary. As a result, elevated leverage can create a structural barrier to sustainable dividend growth.

WHY LEVERAGE MATTERS FOR DIVIDEND INVESTORS

Debt introduces fixed financial commitments that take priority over shareholder distributions. As leverage increases, a larger portion of operating cash flow must be directed toward servicing interest obligations, reducing the capital available to support dividends or reinvestment into the business. Academic research examining the relationship between capital structure and dividend policy has shown that higher leverage levels can constrain dividend flexibility, reinforcing the importance of evaluating debt alongside payout sustainability.⁴

High leverage can impact dividend sustainability in several ways:

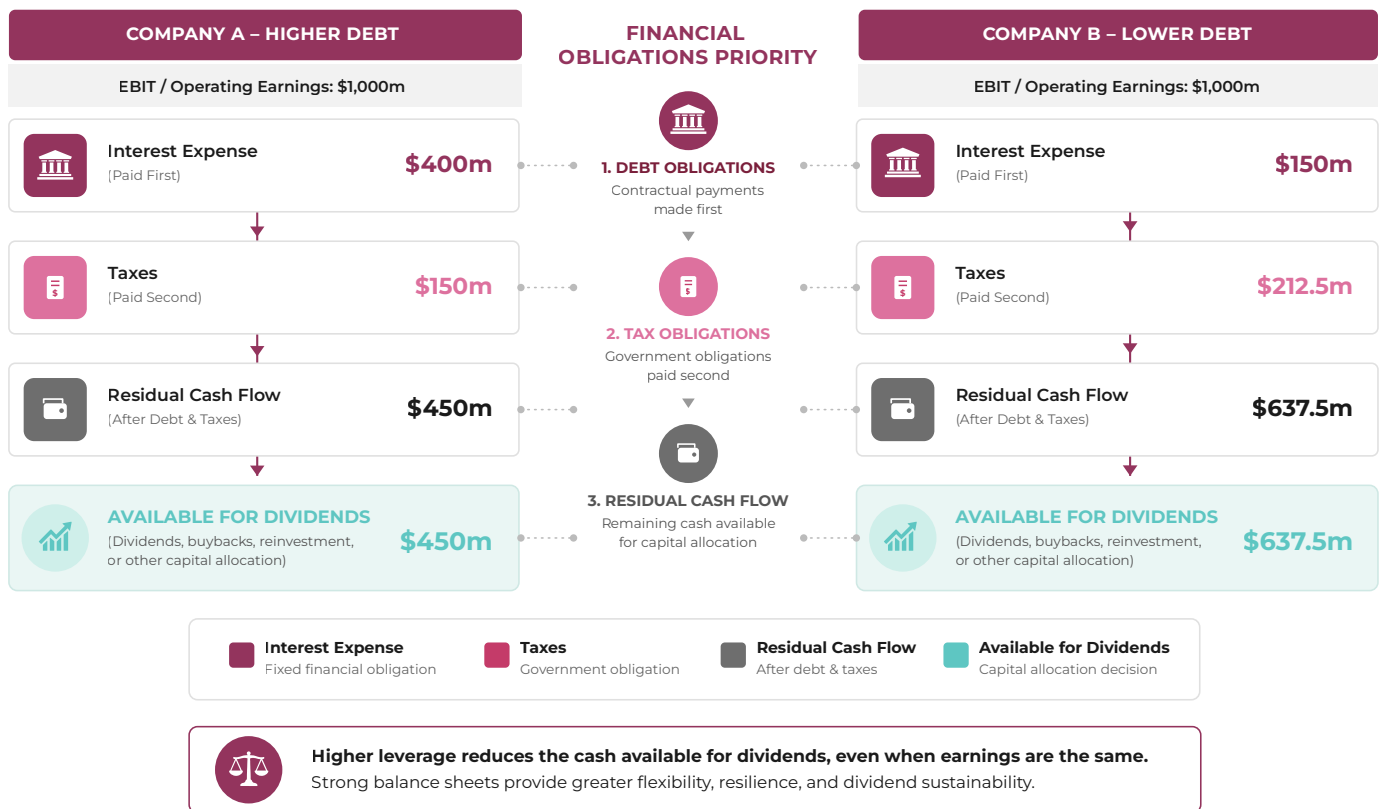
- **Higher servicing costs**
Reduce financial flexibility during economic slowdowns.
- **Interest obligations**
Must be met before capital can be allocated to shareholders.
- **Reduced margin of safety**
Increases the likelihood that dividends become pressured during periods of earnings volatility.

WHY LEVERAGE MATTERS FOR DIVIDEND INVESTORS

Even companies with historically stable dividends may face challenges if rising debt levels constrain future cash flow allocation.

Leverage Shapes Dividend Capacity Debt Obligations Take Priority Before Dividends Same Earnings – Different Levels of Debt

Debt obligations are contractual and must be paid before any cash can be returned to shareholders.



Source: Q Wealth Partners, for illustrative purposes only



ASSESSING FINANCIAL LEVERAGE

An institutional dividend framework therefore extends beyond yield and payout ratios to include balance sheet discipline. Metrics such as debt-to-asset ratios can provide a useful lens into overall leverage levels and financial resilience.

Companies with conservative leverage profiles typically have:

- Greater flexibility to maintain dividends through market cycles.
- Lower refinancing risk.
- More stable long-term capital allocation policies.

Conversely, excessive leverage can erode dividend sustainability, as increasing interest burdens limit the cash available for shareholder distributions.

Operating Quality and EBIT Margins

In addition to payout sustainability and balance sheet discipline, operating profitability plays a critical role in assessing the long-term durability of dividend-paying companies. One useful measure of operating strength is EBIT margin, which reflects a company's ability to generate earnings from its core business before the impact of financing and taxes. Academic research has highlighted the importance of operating profitability as a key indicator of earnings quality and long-term performance, with Robert Novy-Marx demonstrating that firms with stronger operating profitability characteristics tend to exhibit more durable financial outcomes.⁵

Healthy EBIT margins can vary significantly across industries. Asset-light sectors such as software and technology often exhibit higher operating margins (in many cases exceeding 15–20%), reflecting scalable business models and lower capital intensity. By contrast, capital-intensive industries such as energy, industrials, and utilities typically operate with structurally lower margins, often in the range of 5–10%.

Because of these structural differences, evaluating profitability requires an industry-aware lens. Applying overly rigid thresholds risks unintentionally biasing a portfolio toward certain sectors while excluding others that may still exhibit strong financial health within their operating context.

Profitability as a Foundation for Dividend Sustainability

Strong operating margins provide an important margin of safety for dividend investors. Companies with consistent operating profitability are typically better positioned to generate sustainable free cash flow, support dividend growth, and withstand cyclical pressures.

By incorporating EBIT margin analysis alongside payout ratios and leverage metrics, investors can build a more resilient dividend framework, one that emphasizes operating quality rather than yield alone. From a factor perspective, operating margin serves as a practical proxy for profitability, a characteristic widely documented in academic research as a driver of long-term equity performance.

PUTTING IT ALL TOGETHER: THE Q WEALTH INSTITUTIONAL FRAMEWORK

At Q Wealth, dividend investing is not approached as a yield-focused strategy, but rather as part of a broader evidence-based investing (EBI) framework. Each metric, from dividend growth and payout sustainability to leverage and operating profitability, is evaluated through the lens of whether it contributes meaningfully to portfolio construction and delivers consistent factor exposure over time.

Rather than relying on any single indicator, Q Wealth's factor-based portfolios incorporate multiple complementary signals designed to identify companies with durable earnings power, disciplined capital allocation, and resilient financial profiles. The objective is to capture the long-term benefits associated with dividend growth and quality characteristics while minimizing exposure to yield traps or structurally weak businesses.

MANAGING RISK THROUGH PORTFOLIO DESIGN

In addition to quantitative screening, Q Wealth employs structural guardrails to manage unintended risks that can arise in systematic portfolios. These include:

- Stock concentration limits to prevent excessive exposure to any single issuer.
- Sector constraints to reduce unintended biases created by market structure or screening thresholds.
- Diversification overlays designed to maintain balanced factor exposure across industries.
- Liquidity analysis and trade impact assessment to evaluate market depth and trading conditions, helping ensure positions can be implemented efficiently while minimizing market impact and preserving execution quality.

These controls help ensure that the portfolio remains aligned with its investment objective while mitigating the impact of individual securities that may inadvertently pass quantitative filters.

TECHNOLOGY-DRIVEN OVERSIGHT

Putting It All Together: The Q Wealth Institutional Framework

A key component of the Q Wealth framework is the integration of institutional-grade technology to continuously monitor portfolio characteristics. Advanced analytics tools (including Bloomberg's BQNT, PORT optimization and TILTs functionality) are used to assess factor exposures, risk concentrations, and evolving portfolio dynamics. Academic research on factor exposure measurement and quantitative risk models highlights the importance of continuously analyzing portfolio characteristics to ensure alignment with intended investment objectives and risk profiles.^{6 7}

By leveraging systematic analytics alongside predefined portfolio guardrails, Q Wealth seeks to maintain transparency into the underlying drivers of performance. This technology-enabled oversight allows the investment team to identify unintended factor drifts, monitor diversification, and ensure portfolios remain aligned with their intended factor exposures rather than drifting toward unintended market bets

Consistency Through Evidence-Based Investing

By combining systematic research with continuous monitoring, Q Wealth seeks to maintain a high degree of alignment between portfolio construction and intended factor outcomes. This technology-driven oversight enables the investment team to proactively identify shifts in exposures, rebalance risks, and ensure that portfolios remain consistent with their strategic objectives, even as market conditions evolve.

Importantly, the framework remains rules-based, helping to reduce the influence of behavioural biases and emotional decision-making that can arise during periods of market stress. By relying on predefined investment criteria, disciplined portfolio guardrails, and institutional analytics, Q Wealth aims to maintain consistency and objectivity throughout the investment cycle.

Ultimately, the goal is not simply to capture dividend income, but to deliver a repeatable investment process grounded in evidence-based research. Through rigorous screening, systematic implementation, and ongoing oversight, Q Wealth constructs portfolios designed to emphasize sustainable quality, balanced diversification, and long-term total return, reinforcing the role of dividends as one component within a broader institutional framework. In an environment increasingly shaped by narratives and short-term market noise, disciplined, rules-based portfolio construction provides a more durable foundation for long-term dividend investing.

FOOTNOTES

¹ Fama, Eugene F., and Kenneth R. French (1988). Dividend Yields and Expected Stock Returns. *Journal of Financial Economics*, Vol. 22, No. 1, pp. 3–25.

² Ned Davis Research, The Importance of Dividends in Equity Returns, historical equity market analysis.

³ Natalia, Karisma. Dividend Trap: Impact of Yield, Volume, and Payout on Investments.

⁴ Tabot, Samuel. Capital Structure on Dividend Policy: Is There Any Relationship?

⁵ Novy-Marx, Robert (2013). The Other Side of Value: The Gross Profitability Premium.

⁶ MSCI Research Insight. How to Measure Factor Exposures.

⁷ Krishnan Sivaramakrishnan, Kartik; Stubbs, Robert A. Improving the Investment Process with a Custom Risk Model: A Case Study with the GLER Model. STOXX; Axioma, Inc.

ABOUT THE AUTHOR



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Alfred Lee, CFA, CMT, DMS, is the Deputy Chief Investment Officer at Q Wealth Partners, where he is one of the principal architects of the firm's investment platform and asset management business. Alongside the CIO, Alfred is responsible for setting investment direction, overseeing policy and procedural development, and leading portfolio management for Q Wealth's Beta iQ and Factor iQ suite of funds.

Alfred brings over 25 years of investment experience to Q Wealth and has managed some of the largest funds in Canada. Alfred was a Portfolio Manager and Investment Strategist at BMO Global Asset Management. There, he led a team that oversaw the managing and trading over \$50 billion in equity-based strategies—including index, factor, thematic, and sector approaches—and \$30 billion in global fixed income mandates. During the 2020 pandemic, Alfred was seconded to the Bank of Canada, where he served as co-lead manager on one of the central bank's quantitative easing programs, which was authorized to purchase up to \$50 billion in provincial bonds providing funding relief and market stability.

As a senior member of the BMO team, Alfred played a key role in shaping the growth of the firm's ETF franchise—contributing across thought leadership, product development and structuring, portfolio management, trading, business development, and investor education. He was part of the core team that helped build BMO ETFs from a startup platform into one of the largest asset managers in Canada, establishing its position as a dominant force in the domestic ETF market.

Prior to BMO, Alfred led ETF research and manager research at CIBC, where he also supported macroeconomic research for the advisor network. He began his career at RBC, working in its pension consulting division, where he gained foundational experience in institutional portfolio construction and manager oversight.



DISCLOSURES

Quintessence Wealth (Q Wealth) is a partnership that is registered as a portfolio manager, exempt market dealer and investment fund manager. The portfolio manager registration allows Q Wealth to provide investment advice to its clients. The exempt market dealer registration allows Q Wealth to engage in trading activity. These services are provided by Q Wealth through registered advising representatives and dealing representatives, respectively.

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