C | A

CAMBRIDGE ASSOCIATES LLC

EUROPEAN MARKET COMMENT

U.K. DIVIDENDS ON THE UPSWING

November 2004

Eric Winig
Rowan Harmer

U.K. Dividends on the Upswing

Since 1973, dividends have accounted for more than three-quarters of U.K. equities' total return, higher than in any other developed country. Further, over this time period U.K. equities have outperformed a benchmark of global developed markets by 80% in terms of total return, but only 20% when measured by price alone. Similarly, while an investor in U.K. equities earning just the price appreciation would have increased his assets by slightly more than 10 times since 1973—right around the average for developed markets—an investor earning total returns for the period would have increased his wealth by a factor of roughly 45, second only to France. Thus, not only have dividends been the dominant driver of U.K. equity returns, but may become even more important going forward, given that U.K. dividend yields remain on the high end relative to other developed markets, while dividend growth has recently begun to tick higher. We have long advocated the importance of dividends as a more reliable source of returns than capital appreciation, and these historical data certainly illustrate their significance.

From an historical perspective, it appears dividends have more room to grow as dividend growth has only recently risen above its inflation-adjusted long-term average, while dividend yields have remained below their long-term average since the early 1990s (Tables A and B). While dividend growth has been improving since the end of 2000, reaching 3.0% in real terms for the 12 months ended in October 2004, it is still only slightly above its long-term average real growth rate of 1.0%, and far below previous peaks. In addition, at 3.3%, the dividend yield is high relative to that of most other developed country equities, but below its long-term mean of 4.5%.

There are also indications that corporations have room to further expand dividends should they so choose, as the net dividend cover on the FTSE All-Share is currently a strong 2.1. Companies have also ramped up share buyback programs lately, with first half of 2004 activity up 72% over the year-ago period (representing more than 20% of total payouts). While buybacks are a positive for current shareholders, they tend to be less "sticky" than dividends, as it is much easier for a company to discontinue a share repurchase program than to cut an existing dividend. (Including buybacks, true distribution growth is likely close to 15%, and true yields around 4.0%.)

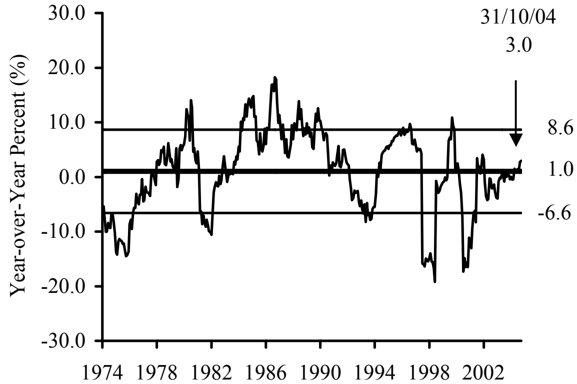
The U.K. equity market tends to be defensive, and relatively high dividend yields coupled with prospects for future dividend growth make it even more so. Overall, rising dividends, coupled with companies' willingness and ability to pay them, give us cause for optimism on U.K. equities.

Table A

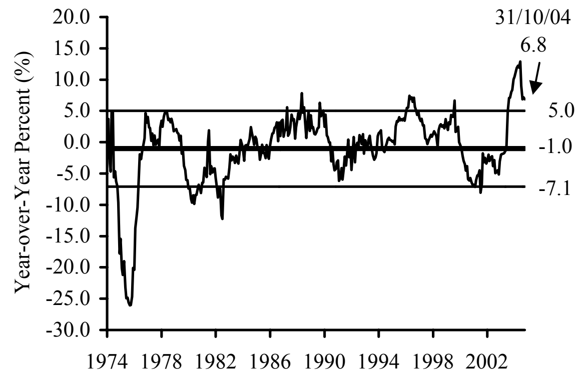
GLOBAL EQUITY MARKET REAL DIVIDENDS PER SHARE GROWTH

28 February 1973 - 31 October 2004

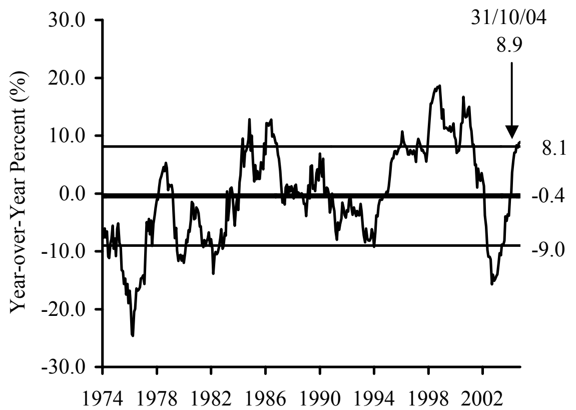
MSCI United Kingdom



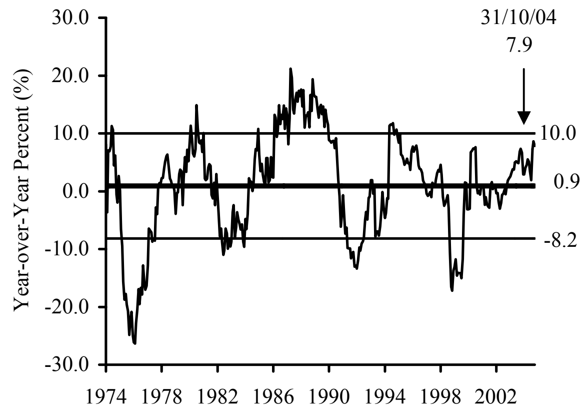
MSCI United States



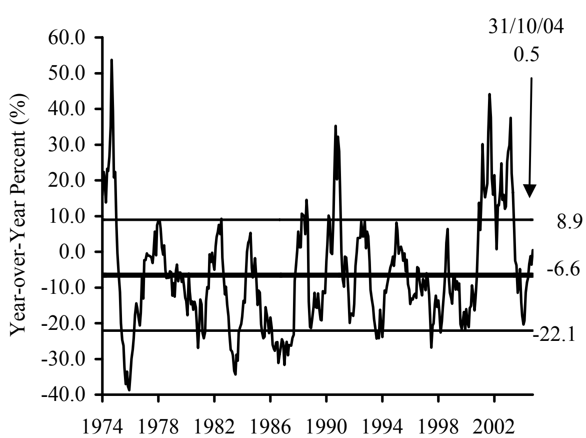
MSCI Europe ex U.K.



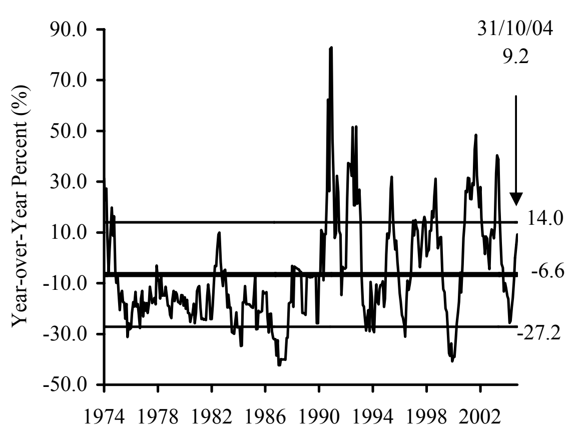
MSCI Pacific ex Japan



MSCI World ex U.K.



MSCI Japan



Sources: Morgan Stanley Capital International and Thomson Datastream. MSCI data provided "as is" without any express or implied warranties.

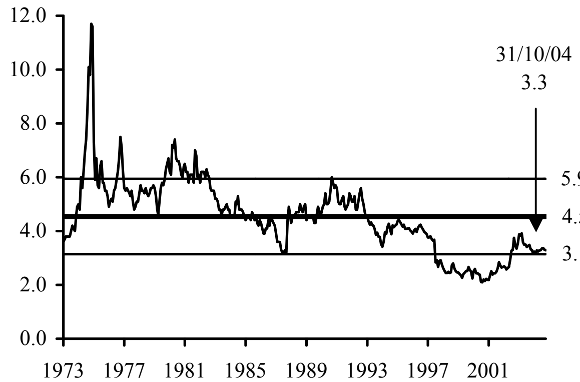
Note: The United Kingdom Retail Price Index is used as a measure of inflation.

Table B

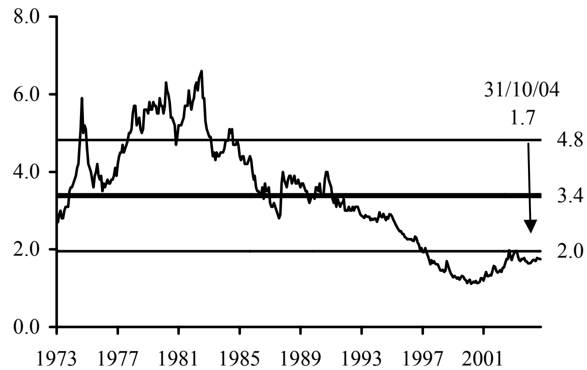
GLOBAL EQUITY MARKET DIVIDEND YIELDS

31 January 1973 - 31 October 2004

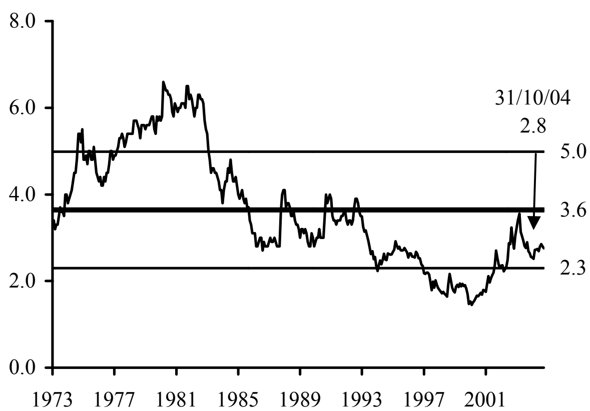
MSCI United Kingdom



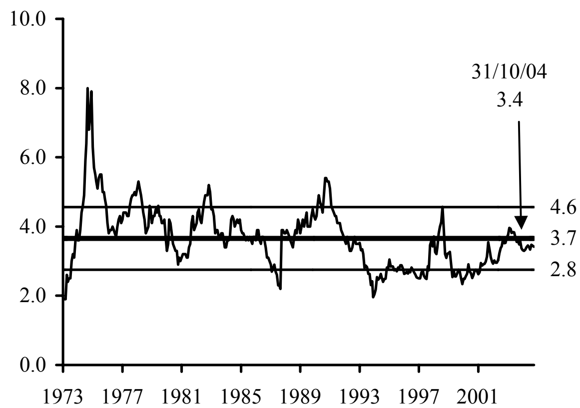
MSCI United States



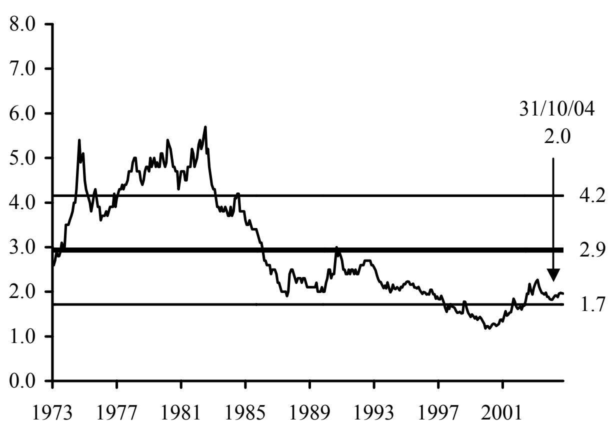
MSCI Europe ex U.K.



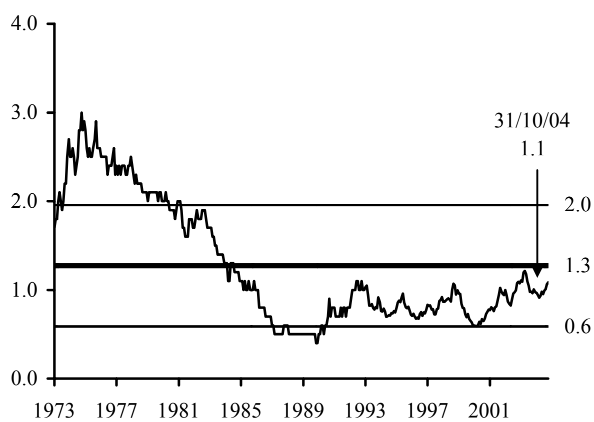
MSCI Pacific ex Japan



MSCI World ex U.K.



MSCI Japan



Sources: Morgan Stanley Capital International and Thomson Datastream. MSCI data provided "as is" without any express or implied warranties.