INVESTMENT UPDATE: DISAPPEARING DIVIDENDS SHOULD RETURN

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The Prime Minister recently announced the gradual easing of lockdown restrictions nearly two months after they were imposed. The restrictions have been largely successful in containing the spread of the coronavirus-new cases have steadily declined since early April and the number of deaths is falling too. However, the slowdown of economic activity has taken a heavy toll on growth. The Bank of England thinks the economy could shrink by 14% this year, although it also forecasts a strong recovery in 2021[1].

The impact on the global stock markets has been well documented, both by the Omnis investment team and the media. After a sharp fall in February, shares have recovered, mainly thanks to the unprecedented support measures launched by governments and central banks. The markets remain sensitive to new developments, as demonstrated by last week's pause, and should continue to fluctuate as we gradually return to normality.

Periods of market turbulence like we have recently experienced are to be expected when you invest in shares. As long as you avoid any knee jerk reactions, then you should be rewarded for holding your investment over the long term. However, another consequence of the coronavirus crisis that may cause concern, particularly for those who rely on their portfolio to generate an income, is the number of companies that have stopped paying dividends.

When you invest in a share, you buy a small piece of the underlying company. Generally, you hope to receive a return if the price of the share has risen once you sell. In some cases, your ownership stake also entitles you to a portion of the profits earned by the company. It distributes these profits by issuing a payment known as a dividend.

According to stockbroker AJ Bell, UK companies have cancelled dividends worth £30 billion since the coronavirus crisis began[2]. Of the 20 biggest dividend payers listed on the UK's FTSE 100 index, seven have so far either cut or withheld their payment for the first quarter of the year. That list includes several popular holdings among income investors, including energy firm British Petroleum, pharmaceutical giant GlaxoSmithKline and HSBC. To make matters worse, the UK government banned companies from issuing dividends if they receive funds from the coronavirus business interruption loan scheme.

No investor wants to miss out on the income stream provided by dividends. However, in times of crisis, preserving cash rather than distributing it to shareholders makes sense, as it allows companies to prioritise their financial health. Many saw demand for their products and services plunge as economic activity came to an effective halt during lockdown, and they may need retained earnings to make up for the subsequent loss of revenues.

A drop in income may cause some investors short-term discomfort, but it is in their long-term interests for companies to practice prudent financial management. These companies should manage to weather the economic slowdown that we are currently experiencing, and could last for several more months, and in a position to take full advantage of the recovery. The good news is they should be able to start issuing dividends again once growth picks up and financially strong enough to keep paying them for a long time after that.

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Sources
[1]https://www.bankofengland.co.uk/-/media/boe/files/monetary-policy-report/2020/may/monetary-policy-report-may-2020
[2]https://www.ajbell.co.uk/news/dividend-cuts-uk-companies-year-exceed-ps30-billion