UK companies a dividend goldmine

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Equity market volatility has increased in recent times and investors have experienced a far bumpier ride in 2018 than the previous year. However, regular dividend payments provide comfort to investors when the value of their investments fluctuates as a result of stock market volatility.

Despite current macro-economic concerns and Brexit uncertainties, company fundamentals are generally strong and increased profits from many UK companies have enabled them to raise dividends.

In 2018 the increase in UK dividend payouts exceeded market expectations, partly due to a particularly strong showing by companies in the financials and mining sectors. A small boost from a weakening pound also resulted in increased sterling values of dividends declared in dollars and euros. Shareholders in BP enjoyed the first dividend increase in four years.

Mining companies contributed most to the dividend growth. Glencore, for instance, restored its payout to full strength by releasing 43% of its earnings as dividend. In the banking sector, sharp profit increases enabled Barclays to raise its interim payout by 150% and its final dividend is likely to jump too. Lloyds continued its winning streak, raising its payout by 10%. Dividends from financial companies were generally strong across the board.

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Retail stood out as a weak spot as the difficulties on the high street have squeezed profits hard, putting pressure on dividends. Most retailers, including M&S and Dixons Carphone, held their dividends flat; others, such as Sainsbury’s, made very modest increases. Next did not pay its perennial special dividend this year and Debenhams’ dividend was halved.

Overall, sectors that contain mature, low growth but stable companies, such as telecoms and utilities, tend to have the highest dividend yields. By contrast, companies in the IT sector, for example, may seize opportunities to reinvest their profit for growth rather than pay it out in dividends.

How to profit from the dividend bonanza?

Over the past year dividend payments have helped the FTSE 100 index outperform other UK indices. At the time of writing, the FTSE 100 supports a hefty 5.0% dividend yield compared to just 3.9% for the FTSE 250. Growing profits and strong cash flow for UK businesses mean that dividends should continue to be well supported.

The FTSE 100 may be experiencing a challenging period currently but this isn’t anything new. Stock markets have always been volatile and investor sentiment has been fickle throughout history. Therefore, the panic-buying of perceived safer assets may be a worthwhile move in the short run, it can lead to underperformance when it comes to capital growth in the long run.

Because of sector concentration, traditional equity income funds that have tended to allocate disproportionately to sectors with the highest dividend yields may contain a hidden risk for investors. Adopting a more flexible approach will allow investors to respond to prevailing market conditions over the short to medium term.

Given that several high quality shares now trade on lower valuations, there could be a buying opportunity for long term investors. While falling share prices may be a cause of concern in the short run, they provide the chance to buy now and to harvest the potential rewards over the long term.