INVESTMENT
INSIGHTS

Delivering for investors with a diversified dividend strategy

Meggan Walsh
Senior Portfolio Manager
and Head of the Dividend Value team
Invesco

Meggan Walsh, lead portfolio manager of Invesco's diversified dividend strategy, discusses the benefits of experience and process discipline in managing a long-term portfolio. Ms. Walsh developed the strategy and has been managing it since its inception in 2002. She and her team find dividend-paying equities that are attractive holdings from the perspective of three key imperatives: capital appreciation, current income and capital preservation. Her background in fixed-income investing informs her focus on companies' balance sheet metrics and stewardship of cash and capital.

P&I: Could you explain the objective of the diversified dividend strategy?

Meggan Walsh: Our investment mandate is to act as a foundation within a diversified portfolio, seeking to deliver strong upside participation with stronger downside protection and adding value with less risk over a full market cycle versus the Russell 1000 Value Index.

P&I: Tell us about your investment team.

Ms. Walsh: The six of us conduct primary research within assigned sectors and industries. On average, we bring 22 years of experience in the industry and 15 years with Invesco. We are all investors.

P&I: What process do you follow to uncover sound investments? Valuation is important. How do you find companies that are attractive from that standpoint?

Ms. Walsh: It's hard to replace the value of time and experience that comes from managing through multiple cycles. This positions us to see past much of the short-term noise in the markets.

Our process focuses on dividend-paying companies where our research shows at least 35% upside potential over a two- to three-year time horizon. Key parts of the investment process are normalized earnings power and valuation frameworks, as well as rigorous downside analysis. We conduct fundamental research to estimate a company's earnings power across a full market cycle. In doing so, we pay particular attention to the quality of the company's earnings, as well as to the strength of the balance sheet and cash flows. We then evaluate a company's valuation using a discounted cash flow analysis, a dividend discount model and traditional market-based multiples over a full market cycle. Downside protection is a key component of our strategy, and we are highly focused on the risk-reward of both new and current holdings. We do this by performing scenario analysis to assess the potential downside risk.

P&I: Many companies have relied on operating leverage to keep earnings growing. Is that particularly important given where we are today in the market cycle?

Ms. Walsh: Yes. It means that we are spending more time understanding the drivers of operating leverage to assess the sustainability of earnings. For example, companies have utilized technology to enhance supply chains and improve productivity this cycle. These are more sustainable drivers of earnings longer term. In contrast, cutting R&D and/or reducing capital expenditures to maintenance levels may not lead to enduring operating leverage improvement.

P&I: How do you keep the strategy running at full speed when you are in a slow economic growth environment? Is it getting harder to find the right companies in today's environment?

Ms. Walsh: Patience is a virtue. Clearly, the opportunity set is not as wide as it was in 2009 and 2010, but there are always dislocations worth evaluating. These dislocations are different each cycle. Currently, there are emerging investment opportunities based on valuations in the energy and industrial sectors.

P&I: How do you factor in the macro issues that seem to have greater impact on corporations in various industries?

Ms. Walsh: Our process is based on fundamental research from a bottom-up perspective. We do not make investment decisions based on predictions of interest rates, commodity prices or exchange rates. However, we are not agnostic to the impact of macro issues on our thesis. This is seen in how we use scenario analysis to assess the potential downside, stressing the key drivers of our financial models to ensure we understand the risk-reward profile of each investment.

P&I: How does the strategy adjust over the market cycle?

Ms. Walsh: The strategy is employed over the full market cycle, meaning it is not adjusted opportunistically. The three components that our process emphasizes – appreciation, income and preservation – are key tenets throughout the cycle. Focusing on total return helps us consistently deliver on our mandate to serve as a conservative foundation in an equity portfolio.

P&I: How do you ensure diversification and minimize downside risk for investors?

Ms. Walsh: We maintain exposure to all 10 sectors at all times, and as a safeguard, we limit our exposure to less than 25% in a single sector and limit individual holdings to no more than 4% at cost. Minimizing downside risk is a key tenet of our process. We perform a rigorous risk-reward analysis on both new and current holdings, and we are focused on the strength of the balance sheet and cash flows.

P&I: When a company reaches full valuation and you want to take profits, how does that work?

Ms. Walsh: We continuously monitor our assessment of the fair value of each stock to determine if trimming or exiting a position is warranted.

P&I: How do you construct a bear case for stocks you are considering adding to the portfolio?

Ms. Walsh: It goes back to the scenario analysis we do for cyclical stocks. We model the normalized earnings power in a bull, base and bear case scenario over a two- to three-year holding period. In the bear case, we stress the key drivers of our financial models to develop an understanding of the potential downside risk to our thesis.

P&I: How should institutional investors think about this strategy in the context of their overall asset allocation?

Ms. Walsh: We believe that our portfolio is a conservative foundation for an investor's broader portfolio. How deep the foundation is a function of the investor's risk tolerance and time horizon. ❖

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P&I CONTENT SOLUTIONS GROUP

DIVERSIFIED DIVIDEND STRATEGY

LEAD PORTFOLIO MANAGER: Meggan Walsh

- Team founder and Lead Portfolio Manager since Dec. 31, 2002
- This stable portfolio management team has an average 22 years of investment experience and 15 years with Invesco.

VEHICLES OFFERED

- Mutual funds
- Separate accounts
- Collective trusts

STRATEGY SPOTLIGHT

Investment objective

Capital growth with a secondary objective of current income sought by selecting stocks that offer total return potential from price appreciation and dividend return.

Distinguishing attributes

- TOTAL RETURN APPROACH. This investment process seeks to balance capital appreciation, current income and capital preservation over a full market cycle.
- SUSTAINABLE AND GROWING DIVIDENDS. Emphasizes the growth and sustainability of a company's dividend, as companies with these characteristics have historically outperformed.
- BALANCE SHEET EMPHASIS. Fundamental research begins with the balance sheet, focusing on firms with sound capital structures.
- VALUATION. A triangulation approach plus stress testing analysis — we triangulate fair value using discounted cash flow and dividend discount formula model analysis based on our view of normalized returns for the business and historical company valuation comparisons across full economic cycles.
- STRONG HISTORICAL LONG-TERM RESULTS. This strategy has outperformed its benchmark[2] with less risk over full market cycles.

KEY CONTACTS

Eric Johnson
Head of Sales,
Service and Consultant Relations
(212) 278-9834
eric.johnson@invesco.com

Clint Harris
Senior Client Portfolio Manager
(713) 214-1601
clint.harris@invesco.com

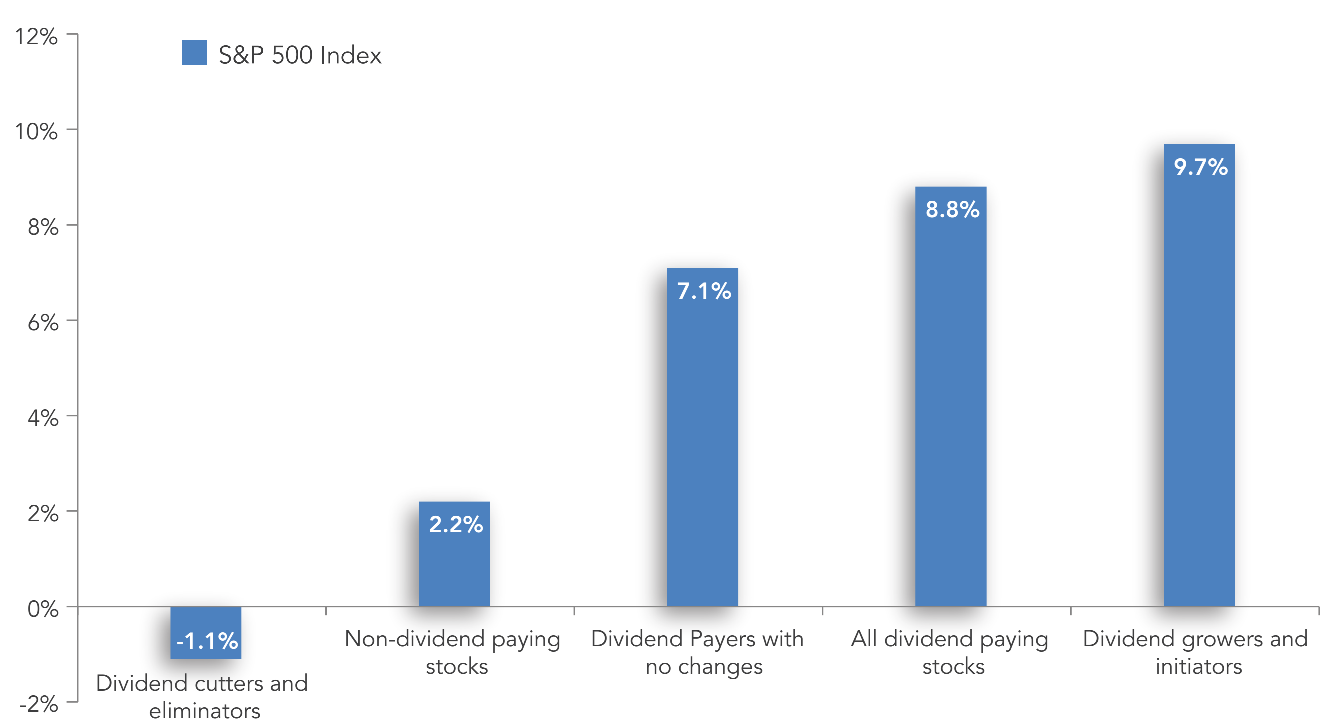
$775,586[1]
Invesco AUM ($Millions)

$261,240[1]
Invesco Institutional AUM ($Millions)

[1]As of Dec. 31, 2015

DIVIDEND GROWERS AND INITIATORS HAVE OUTPERFORMED OTHER COMPANIES

Average annual total returns of the S&P 500 Index stocks by dividend policy.
30-year period ended Feb. 29, 2016



Source: 2016© Ned Davis Research, Inc. Past performance does not guarantee future results. An investment cannot be made directly into an index.

All stocks were categorized by the following methodology for total return of each 12-month period over the course of the last 30-year period ended Feb. 29, 2016. Dividend cutters and eliminators represents stocks in the S&P 500 Index that have lowered or eliminated their dividend; non-dividend-paying stocks represent non-dividend-paying stocks of the S&P 500 Index; dividend payers with no change represent all dividend-paying stocks of the S&P 500 Index that have maintained their existing dividend rate; all dividend-paying stocks represent all dividend-paying stocks in the S&P 500 Index; and dividend growers and initiators represent all dividend-paying stocks of the S&P 500 Index that raised their existing dividend or initiated a new dividend.

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[2]The Custom Diversified Dividend Index is comprised of the Russell 1000 Index through Feb. 28, 2012, and the Russell 1000 Value Index from that date forward.

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