WELLS FARGO
Investment Institute

Concept Review

Global Securities Research February 12, 2025

Diversified Stock Income Plan (DSIP) List

DSIP List objective

The DSIP List focuses on companies that we believe will provide consistent annual dividend growth over a long-term investment horizon. Our objective is to provide a broad list of high-quality, industry-leading companies from which an investor can assemble a well-diversified portfolio. Through consistent dividend growth, our goal is to help investors stay ahead of the wealth-eroding effects of inflation. The DSIP List is not a discretionary managed strategy offered through an advisory program and is not available for direct investment.

DSIP List — Concept review

Overview

The DSIP List (the List) is a long-term, buy-and-hold strategy based on the belief that the value of a company is a reflection of the cash flow it generates for its owners. As minority owners in public companies, investors' tangible share of that cash flow comes as dividend payments. If investors select companies that consistently increase cash flow and deliver rising dividends, over time, we expect that the companies' stock prices should reflect that growth and create attractive prospects for total returns. The objectives of the DSIP List are as follows:

Provide a higher stream of income over time: With a list of stocks that we believe have the potential to raise their dividends with regularity, investors should be able to keep up with the rising cost of living and generate attractive total returns. To help achieve this goal of a growing income stream, we recommend that investors plan to hold these stocks for a minimum of five years.

Manage risk through diversification: A well-constructed portfolio typically contains stocks from several different sectors. At a minimum, we recommend a portfolio should contain 20 to 30 stocks spanning six to eight sectors with different investment characteristics. With the DSIP List, we intend to provide recommendations across sectors, market capitalizations, and growth profiles, among other factors, to facilitate proper portfolio construction.

Investment and Insurance Products: ➤ **NOT FDIC Insured** ➤ **NO Bank Guarantee** ➤ **MAY Lose Value**

Keep you informed about these stocks through your investment professional: We notify our investment professionals whenever a DSIP List stock announces a dividend change, if we add or remove a stock from the List, or if any other significant events occur. We also publish quarterly updates summarizing activity in the List and performance results as well as other reports on topics of interest.

Criteria

The only criteria for DSIP List inclusion is our belief that a company offers the potential to consistently increase its dividend at an attractive rate over a long-term investment horizon. Fundamental factors that, in our view, can support consistent dividend growth include:

- **Financial condition:** We prefer companies that are fundamentally sound and, if applicable, have investment-grade debt. A solid balance sheet can provide flexibility during periods of subpar financial results.
- **Growth profile:** We prefer companies that consistently grow earnings and free cash flow (cash remaining after expenses are paid) as this is necessary to support sustainable dividend growth. A long history of dividend increases is valuable in that it can provide insights into how a company thinks about dividend payments, but we do not require a specific record of dividend increases for inclusion on the DSIP List.
- **Payout ratio:** We prefer companies with business-appropriate payouts of earnings and free cash flow. Payout ratios vary, with lower-volatility industries typically able to support higher payout ratios while more cyclical industries typically operate with lower payout ratios.
- **Business model:** We generally prefer high-quality, industry-leading companies that operate mature, defensive businesses and provide products or services that customers generally tend to patronize across economic cycles.

We are unlikely to recommend every stock that meets the basic criteria for inclusion on the DSIP List but rather only those in which we have the highest confidence. Additionally, while we are cognizant of company valuation levels and overall sector weightings, these two factors minimally impact DSIP List addition decisions.

Removing stocks

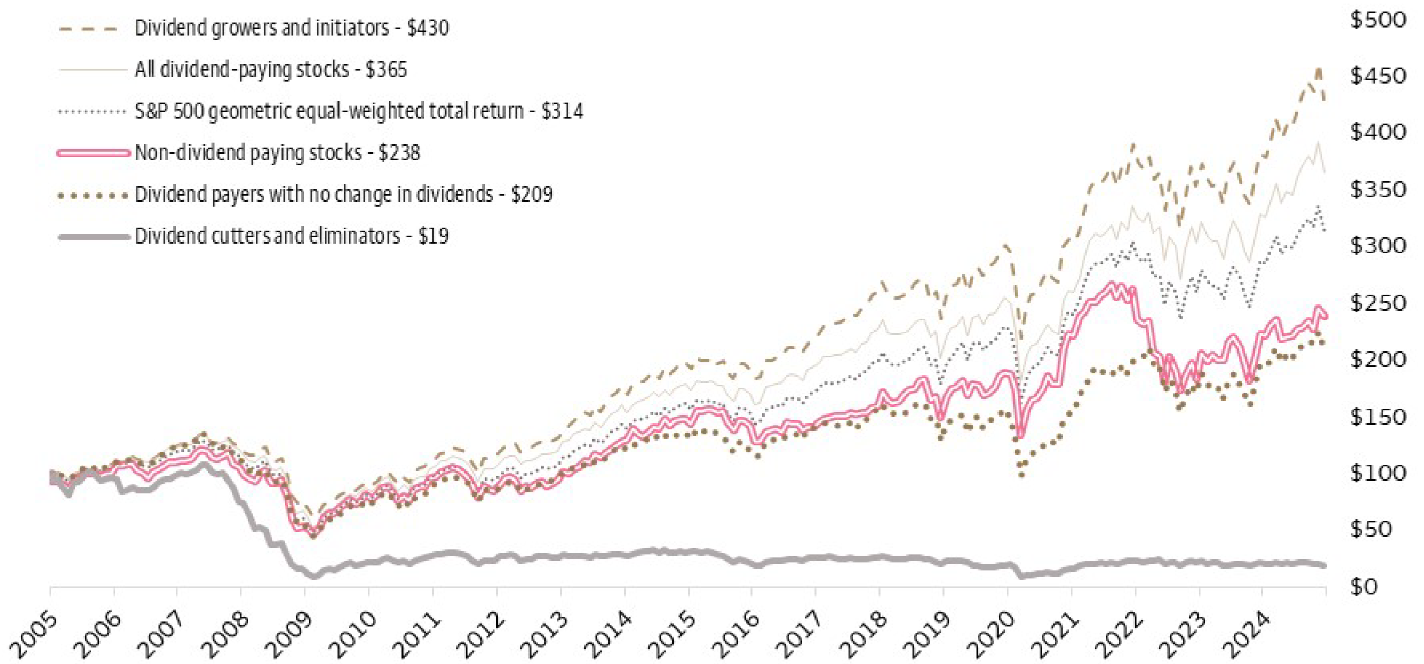
In our view, many successful investors set emotions aside and seek to patiently build wealth over time. With this long-term approach in mind, we intend to recommend companies through economic and market cycles, removing them from the DSIP List if the fundamental characteristics that support dividend growth have deteriorated or are expected to do so, thus decreasing or eliminating our dividend-growth thesis. An extended period of dividend growth at levels below our expectation could also be cause for removal. Like an addition, company valuation and the DSIP List's overall sector weightings have minimal influence on removing a stock.

Why rising dividends?

History has shown that investing in stocks of high-quality dividend-growing companies over long periods of time can be a successful strategy to help investors build wealth. Receiving cash dividends up to four times a year with the prospect of dividend increases at least once per year from a properly diversified portfolio should help investors participate in the wealth-building potential of the market, even in uncertain or volatile times. Figure 1 from Ned Davis Research shows the returns of S&P 500 Index stocks categorized by dividend policy. In our view, this figure highlights the significance of dividend growth, and dividends in general, with regard to long-term returns. Over the 20-year period shown, the *Dividend growers and initiators* subset produced the largest return, followed by the *All dividend-paying stocks* group. Notably, *Non-dividend paying stocks* and *Dividend payers with no change in dividends* tracked closely together through much of this period, implying *Dividend growers and initiators* had an outsized impact on the *All dividend-paying stocks* subset. Our final

observation from this figure is the importance of avoiding companies that cut or eliminate dividends as this subset not only lost 75% of its value over the timeframe but was also well behind every other category.

Figure 1: Growth of $100 based on returns of S&P 500 stocks by dividend policy (2005 – 2024)



Source: Ned Davis Research. Ned Davis Research has used data provided by Refinitiv and S&P Global in this analysis. Index return information is provided for illustrative purposes only. **Index returns are not fund returns and are not a forecast of expected gains or losses a fund might experience.** Index returns reflect general market results, assume the reinvestment of dividends and other distributions and do not reflect deduction for fees, expenses or taxes applicable to an actual investment nor do they constitute a recommendation to invest in any particular fund or strategy. The S&P 500 Index is a market capitalization-weighted index generally considered representative of the U.S. stock market. An index is unmanaged and not available for direct investment. There is no guarantee that dividend-paying stocks will return more than the overall stock market. Dividends are not guaranteed and may be reduced, changed, or eliminated at any time. **Past performance is no guarantee of future results.** Monthly Data 1/1/2005 – 12/31/2024. Returns based on monthly equal-weighted geometric average of total returns of S&P 500 component stocks, with components reconstituted monthly. **Copyright 2025 Ned Davis Research, Inc. Further distribution prohibited without prior permission. All Rights Reserved.**

Benchmark

Our benchmark for DSIP List performance comparisons is the S&P 500 Index. The S&P 500 Index includes roughly 500 of the largest companies across the 11 Global Industry Classification Standard (GICS) sectors. The S&P 500 Index is market-value-weighted and is designed to measure the performance of the large-capitalization segment of the U.S. equity markets.

For a detailed discussion of list performance, please refer to the list's Quarterly Performance report.

Investment considerations

We consider the DSIP List appropriate for conservative investors seeking some income and growth from their equity portfolios. It may also be appropriate for more aggressive investors who prefer to keep a portion of their portfolios in more conservative equities. Investors with a long-time horizon can potentially benefit from decades of dividend growth and reinvestment in a diversified portfolio of DSIP List stocks. We believe that investors looking to build or rebuild their retirement accounts may consider this list appropriate. Retired individuals may benefit from the possibility of receiving annual dividend increases from a relatively low-volatility strategy. In our opinion, the decision as to whether a particular security is appropriate for an individual portfolio should be made by investors with their investment professional, with full consideration given to existing portfolio holdings as well as investment objectives, risk tolerance, and time horizon.

Dividend reinvestment

One way to potentially enhance the total return potential of a portfolio is reinvesting cash dividends to buy more shares of stock. A dividend-reinvestment program allows for automatic reinvestment of dividends into additional shares of the stock. If the dividends are reinvested on a day when the share price is lower, more shares are purchased; alternately, if the stock price is higher, fewer shares are purchased. A systematic investment plan does not guarantee a profit or protect against loss in a declining market, and investors should consider their ability to continue investing through periods of low price levels. We believe investors who reinvest dividends as well as investors who want to initiate or add to stock positions should welcome market pullbacks. Ask your investment professional about dividend reinvestment, a service that we believe can allow you to take full advantage of the compounding effect of your dividend income.

Disclaimers

All investments are subject to market risk which means their value may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors due to numerous factors some of which may be unpredictable. Be sure you understand and are able to bear the associated market, liquidity, credit, yield fluctuation and other risks involved in an investment in a particular strategy.

Equity securities are subject to market risk which means their value may fluctuate in response to general economic and market conditions and the perception of individual issuers. Investments in equity securities are generally more volatile than other types of securities.

There is no guarantee dividend-paying stocks will return more than the overall market. Dividends are not guaranteed and are subject to change or elimination.

Sector investing can be more volatile than investments that are broadly diversified over numerous sectors of the economy and will increase a portfolio's vulnerability to any single economic, political, or regulatory development affecting the sector. This can result in greater price volatility. **Communication Services** companies are vulnerable to their products and services becoming outdated because of technological advancement and the innovation of competitors. Companies in the communication services sector may also be affected by rapid technology changes, pricing competition, large equipment upgrades, substantial capital requirements and government regulation and approval of products and services. In addition, companies within the industry may invest heavily in research and development which is not guaranteed to lead to successful implementation of the proposed product. Risks associated with the **Consumer Discretionary** sector include, among others, apparel price deflation due to low-cost entries, high inventory levels and pressure from e-commerce players, reduction in traditional advertising dollars, increasing household debt levels that could limit consumer appetite for discretionary purchases, declining consumer acceptance of new product introductions, and geopolitical uncertainty that could affect consumer sentiment. **Consumer Staples** industries can be significantly affected by competitive pricing particularly with respect to the growth of low-cost emerging market production, government regulation, the performance of the overall economy, interest rates, and consumer confidence. The **Energy** sector may be adversely affected by changes in worldwide energy prices, exploration, production spending, government regulation, and changes in exchange rates, depletion of natural resources, and risks that arise from extreme weather conditions. Investing in the **Financial Services** companies will subject an investment to adverse economic or regulatory occurrences affecting the sector. Some of the risks associated with investment in the **Health Care** sector include competition on branded products, sales erosion due to cheaper alternatives, research and development risk, government regulations and government approval of products anticipated to enter the market. There is increased risk investing in the **Industrials** sector. The industries within the sector can be significantly affected by general market and economic conditions, competition, technological innovation, legislation and government regulations, among other things, all of which can significantly affect a portfolio's performance. **Materials** industries can be significantly affected by the volatility of commodity prices, the exchange rate between foreign currency and the dollar, export/import concerns, worldwide competition, procurement and manufacturing and cost containment issues. **Real estate** investments have special risks, including possible illiquidity of the underlying properties, credit risk, interest rate fluctuations, and the impact of varied economic conditions. Risks associated with the **Technology** sector include increased competition from domestic and international companies, unexpected changes in demand, regulatory actions, technical problems with key products, and the departure of key members of management. Technology and Internet-related stocks, especially smaller, less-seasoned companies, tend to be more volatile than the overall market. **Utilities** are sensitive to changes in interest rates, and the securities within the sector can be volatile and may underperform in a slow economy.

Diversification does not guarantee a profit or protect against loss.

Standard & Poor's uses upper-case letters to identify a bond's credit quality rating. 'AAA' and 'AA' (high credit quality) and

'A' and 'BBB' (medium credit quality) are considered investment grade. Credit ratings for bonds below these designations ('BB', 'B', 'CCC', etc.) are considered low credit quality, and are commonly referred to as "junk bonds". Ratings may be modified by the addition of a plus (+) or minus (-) sign to show relative standing within the major rating categories.

Earnings per share (EPS) is the portion of a company's profit allocated to each outstanding share of common stock. EPS serves as an indicator of a company's profitability.

Price to earnings ratio (PE ratio) is a valuation ratio of company's current share price compared to its per-share earnings. PE = market value per share/EPS.

Dividend payout ratio is the percentage of a company's earnings paid out as dividends. Dividend payout ratio = dividend per share / EPS.

S&P 500 Index is a market capitalization-weighted index composed of 500 widely held common stocks that is generally considered representative of the U.S. stock market. An index is unmanaged and not available for direct investment.

S&P 500 Equal Weight Index is the equal-weight version of the widely-used S&P 500 Index.

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