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OBSERVATIONS ON THE MARKET

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It's called "Present Bias." No, this is not something that affects us every December 25th. It is a term used to explain why it is so difficult to do things like save money or lose weight (which we know are good for us in the future), but we instead go for the immediate gratification. There is a great article in the winter edition of *Morningstar*, which explores why so many people postpone saving and investing for tomorrow just so they can buy more stuff today (email me if you would like a copy). Present Bias helps explain why growth investing has gained such popularity despite the evidence that suggests long-term, those boring little dividends do give growth investing a run for the money (sorry).

Let us go back to March 2001. You are offered a choice of purchasing Southern Company, one of the largest utility companies in the country, or a fund which began in March 2001 and owns only shares of Microsoft, Apple, Amazon, Facebook, Alphabet, and other tech companies (these five represent 40% of the fund). In 2001, Southern Company was and still is basically a regulated utility. They are told how much they can charge their customers. However, they do pay an attractive dividend for income investors. Microsoft, Apple, Amazon, and Facebook as everyone knows, are not regulated companies. They have become some of the world's most valuable companies. Here is where Present Bias comes in. Every investor is aware of the growth these companies have achieved. It is well publicized in each quarterly report. What does not make headlines is the slow steady dividend growth of Southern Company. In the beginning the dividends don't seem like much. However, as the chart below shows, turtles do win races. Since 2001, the total return of Southern Company beats the world's most valuable tech companies by 200%. There is a simple explanation.

"I don't know what the seven wonders of the world are, but I know the eighth, compound interest" – Baron Rothschild. If you have a dividend income of $10,000, and it grows by 6% per year for ten years, your income reaches $17,900. The beauty of compound interest comes in the second decade, where your growth is not another $7,900 of interest income, it is now up to $32,000. The interest earns interest, and in this case that totals $14,100 in the second decade of 6% growth. So, while Apple, Facebook, and Amazon are great growth stories, magic is also happening with a utility company that just simply growths it's dividend every year. It only takes 6%, but give it enough time, and compounding can give the best growth companies a run for the money.

Dividend investing has gained in popularity in the last several years. Probably for the wrong reason. Investors are looking for sources of higher income, they are not really interested in the results 10 or 20 years from now. Present Bias suggests that a future that is 10 or 20 years from now is much too cloudy. There is way too much uncertainty in the next quarter, never mind the next decade. It is very difficult to visualize those little dividend checks growing by a factor of 300% when they start out at 3%. Another important point of Present Bias is that things that are farther away look smaller than things that are right next to us. Something 10 miles away looks much smaller than if it is right in front of us. Images in our mind work sort of the same way. Present Bias seems to be a good explanation as to why simple dividend growth investing isn't that popular as a long-term investment strategy.

If you are wondering how likely dividends of the S&P 500 can continue to grow at 6% per year, just consider what they have done for the last 70 years. Regardless of inflation, taxes, politics, wars, and recessions, dividend growth has remained remarkably steady at about 6%. It would appear the odds are better that dividends will grow by 6% in the coming decade than Apple, Microsoft, or Amazon will become $2 trillion companies. (The top line of the chart is Southern Company)