Searching for Great Dividend Funds

What separates the best from the rest?

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Contents

Todd Trubey
Senior Analyst
Todd.Trubey@morningstar.com

Daniel Sotiroff, CFA
Senior Analyst
Daniel.Sotiroff@morningstar.com

Executive Summary

Dividend funds have a strong following, and it's easy to understand their appeal. Dividends provide tangible cash flow to a fund's investors and often provide regular income. Some dividend-oriented funds have the characteristics of great long-term investments and reasonably remain a popular choice among investors.

Dividend funds encompass a variety of strategies. Income-oriented funds seek a higher yield than the market by holding higher-yielding stocks. But not all dividend funds share that goal. Dividend growth funds focus on stocks that consistently grow their regular cash dividends over long periods of time. These funds typically have a yield that's closer to the market's yield, and a different risk/reward profile than their income-oriented counterparts. And some funds blend these preferences to deliver current income as well as expected dividend growth. This paper outlines the characteristics that typically define each style and the trade-offs in their expected performance.

The last section of this paper is a "how to" guide that's meant to help investors identify dividend funds that are built to perform well over the long run. It walks through the important criteria to focus on and what to avoid, and it highlights some of Morningstar's top-rated funds, both actively managed and index-tracking.

Key Takeaways

- The current universe of dividend funds in Morningstar Direct consists of 348 open-end mutual funds and exchange-traded funds.
- Dividend funds represented just over USD 1 trillion of investors' money at the end of September 2023.
- Dividend funds generally come in three flavors: dividend income, dividend growth and income, and dividend growth.
- Dividend income funds typically have a higher dividend yield than the market and a value orientation.
- Dividend growth funds focus on stocks that consistently grow their dividends over time and usually have yields that are comparable to the market.
- Growth funds hold more wide-moat stocks than income funds and tend to be less risky.
- Total return is composed of two components: price appreciation and yield, which usually trade off. Increasing yield usually decreases potential price appreciation.
- Not reinvesting dividends eats into the total return that an investor experiences.
- Low fees and broad diversification tend to define the top-performing dividend funds, and they are among the most important traits to consider when selecting a fund.

- Actively managed dividend funds usually struggle to outperform low-fee index-tracking dividend funds over the long run.

The State of the Dividend Fund Universe

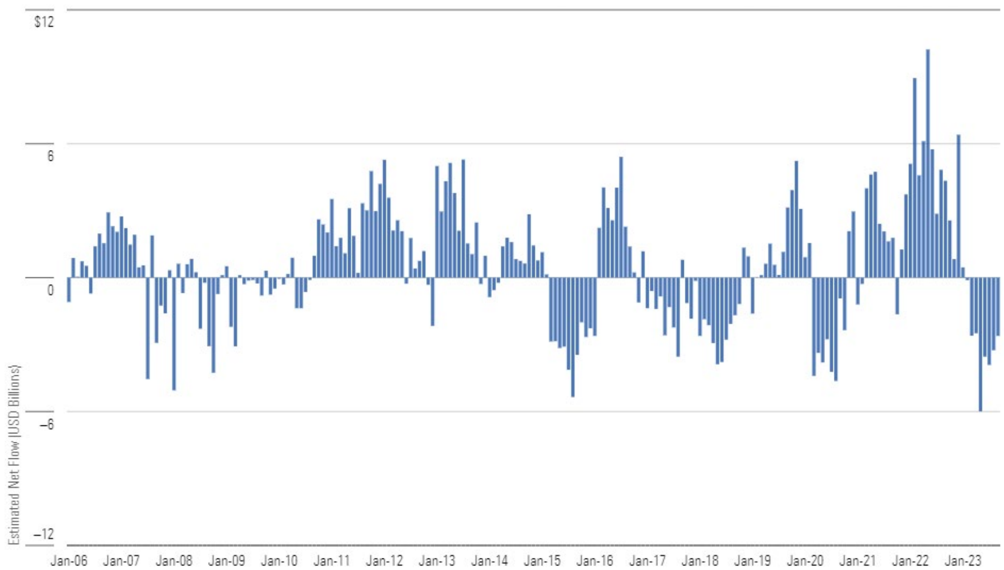
Dividend-oriented equity funds have had a big following over the past decade. Popular options include Schwab US Dividend Equity ETF SCHD and Vanguard High Dividend Yield ETF VYM, both of which have Morningstar Medalist Ratings of Gold, but investors have a long menu of dividend funds to choose from. The full list of dividend funds used for this paper was built from a simple set of rules that scoured 20 Morningstar Categories for U.S.-domiciled equity funds that intentionally invest in dividend-paying stocks—those that used the words “Dividend,” “Income,” or “Yield” in their name, and those that were flagged as dividend-oriented strategic-beta funds. The full search criteria are outlined in Appendix A.

Applying those rules to Morningstar Direct’s universe of ETFs and open-end mutual funds produced a list of 348 U.S.-domiciled dividend funds, as of September 2023. About 82% of these funds (286) had a track record of at least five years.

Many investors turn to these funds for the income they can provide. And they remain popular for that reason, even as interest rates have returned to levels that resemble their long-term historical norm. Collectively, the full roster of 348 dividend funds had just over USD 1 trillion of investors' money at the end of September 2023.

While dividend funds represent a considerable chunk of U.S. fund assets, flows have tended to ebb and flow. Dividend funds collectively experienced positive flows through most of 2019’s rally, but investors pulled money out after the onset of the coronavirus pandemic in 2020. They put new money to work through most of 2021 and 2022. Exhibit 1 shows the timing of these flows going back to 2006.

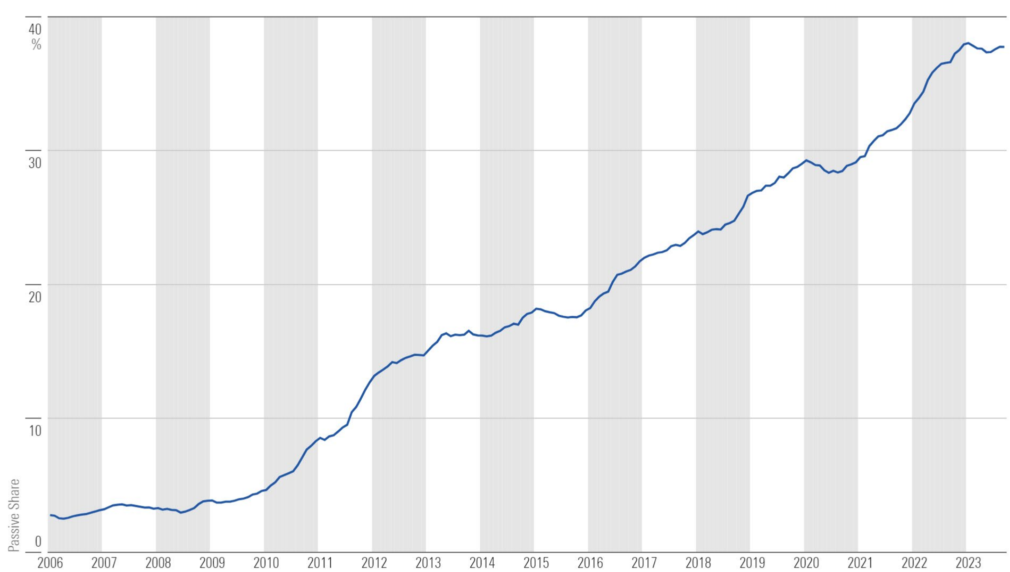
Exhibit 1 Flows Wax and Wane



Source: Morningstar Direct. Data as of Sept. 30, 2023.

Consistent with trends in the broader U.S.-domiciled fund universe, the money invested in dividend funds has steadily shifted toward passively managed index-tracking funds from active. Exhibit 2 shows the market share of index-tracking dividend funds stood at nearly 38% of U.S.-domiciled dividend fund assets at the end of September 2023, up from just 3% in January 2006.

Exhibit 2 The Active/Passive Split



Source: Morningstar Direct. Data as of Sept. 30, 2023.

Active managers haven't watched this trend from the sidelines. Many have launched ETFs to win assets. Actively managed ETFs represented about 71% of the dividend-oriented funds launched since January 2018.

Not All Dividend Funds Are Alike

One of the most important distinctions among dividend strategies arises from the way they use dividends to select stocks for a portfolio, which leads to differences in the risks they incur. Morningstar classifies dividend funds into three different cohorts:

1. Those that focus heavily on dividend income;
2. Those holding stocks that consistently increase their dividends over time, thus signaling overall resilience and future growth; and
3. Those that strike a balance between future growth and current income.

Dividend income portfolios typically hold stocks with higher yields than the market, but they tend to grow their dividend payments at a slower rate, if at all. These may be mature companies with limited growth opportunities or those faced with deteriorating business conditions. They tend to pay a larger share of their earnings as dividends, which usually leads to lower earnings growth and, as a result, lower dividend growth than the average company. In either case, these funds typically sport lower average valuations than the market and land on the value side of the Morningstar Style Box. They can be among the riskier dividend strategies available.

The dividend payments of such companies are at risk if business conditions deteriorate. For example, General Electric's GE share price began declining in early 2017 as its profits slowed. Executives responded by halving the firm's dividend in December of that year (to USD 0.48 per share from USD 0.96 per share annually). But its share price continued falling in 2018, which pushed its yield higher. While its dividend yield looked attractive, management ultimately slashed the annual dividend to USD 0.04 per share in December 2018.

Dividend growth funds have less exposure to dividend cuts. They are willing to accept lower current yields in exchange for higher future payouts and typically favor stocks with durable competitive advantages, long histories of dividend growth, and strong profitability. Such stocks tend to trade at higher price multiples than those with higher dividend yields, reflecting their better outlooks but also raising the hurdle for future returns.

That framework informs how Morningstar classifies dividend funds. Objective metrics assign a fund to a dividend income, dividend growth and income, or dividend growth cohort. Those data points are expected yield, coverage ratio (expected earnings divided by expected dividends), profitability, and dividend-growth rate. Appendix B outlines the full details of these sorting rules.

Funds in the first cohort comprise dividend income funds—those with higher yields, lower coverage ratios, lower profitability, and lower dividend-growth rates. Dividend growth funds make up the third cohort and have the opposite characteristics as the income funds, while those in the growth and income cohort had metrics that landed in the middle. Exhibits 3 and 4 show the median characteristics of each cohort. For the most part, the median characteristics largely fall out of the logic used to sort them.

Exhibit 3 Median Characteristics of U.S. Dividend Fund Cohorts

U.S. Fund Cohort	Trailing 12-Month Yield (%)	Profitability (ROIC)	Div Growth Rate (%)	Coverage Ratio (E/D)	% Wide Moat
Dividend Income	2.97	12.9	4.0	2.2	38.3
Dividend Growth and Income	2.12	15.6	2.9	2.9	52.2
Dividend Growth	1.53	19.1	5.5	3.5	58.7
Vanguard Total Stock Market ETF VTI	1.57	17.7	6.3	3.1	60.0

Source: Morningstar Direct. Data as of Sept. 30, 2023.

Exhibit 4 Median Characteristics of International/Global Dividend Fund Cohorts

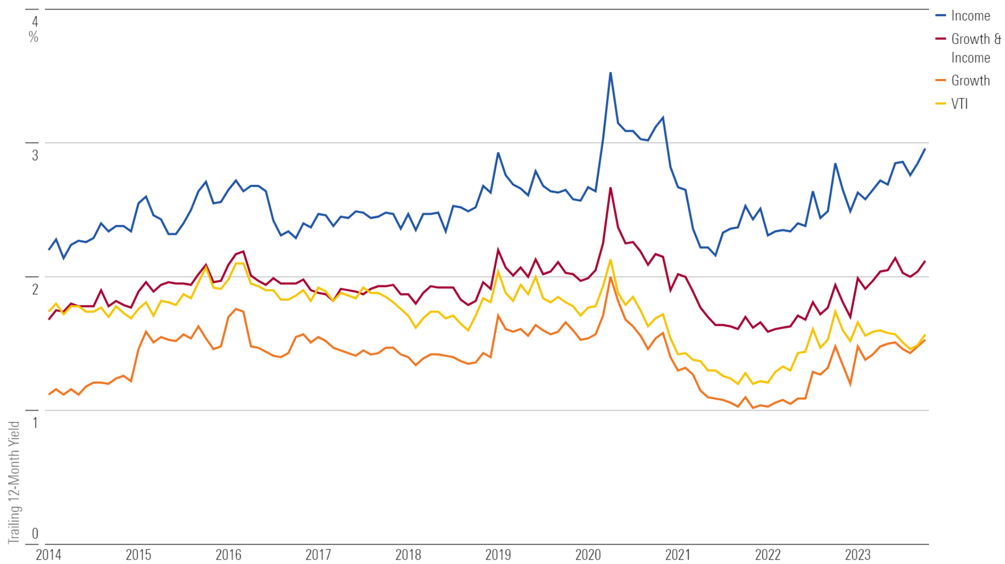
International/Global Fund Cohort	Trailing 12-Month Yield (%)	Profitability (ROIC)	Div Growth Rate (%)	Coverage Ratio (E/D)	% Wide Moat
Dividend Income	4.85	12.6	1.8	2.1	11.5
Dividend Growth and Income	4.33	13.9	4.2	2.3	33.3
Dividend Growth	2.51	16.9	4.4	2.6	45.7
Vanguard Total International Stock ETF VXUS	3.11	12.7	0.6	2.5	33.9

Source: Morningstar Direct. Data as of Sept. 30, 2023.

The differences between cohorts become evident when grouping these dividend strategies and comparing their characteristics. Yet yield still takes priority for many investors. Exhibits 3 and 4 show that the income cohorts offered a higher yield than the market, while the yield of the growth cohorts landed closer to the market. That observation has held over time.

Exhibit 5 shows the median yield of each U.S. cohort over the 10 years through September 2023. In general, a typical U.S. dividend income fund offered between 0.5 and 1.5 percentage points more yield than Vanguard Total Stock Market ETF VTI—a proxy for the U.S. market. The median yield for the dividend growth cohort was lower, often hovering near that offered by VTI. Similar results were observed among the international/global dividend funds.

Exhibit 5 Median Yield of U.S. Dividend Fund Cohorts



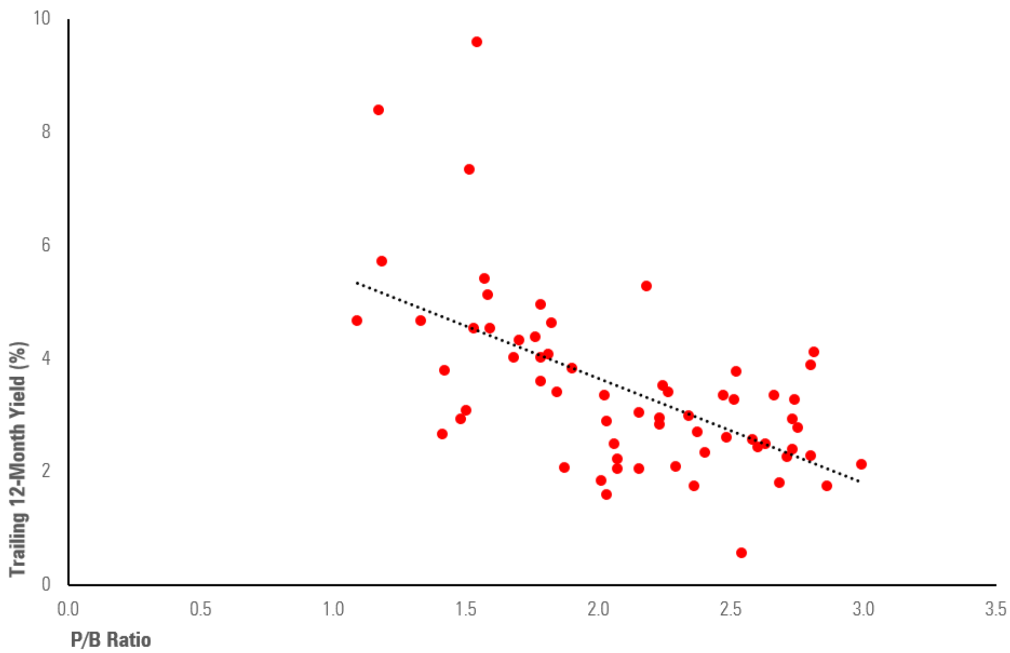
Source: Morningstar Direct. Data as of Sept. 30, 2023.

Risk and Reward

The different fundamentals and risk profiles of each cohort help explain how it tends to perform. In general, dividend income funds incur more risk than dividend growth funds, though the additional risk doesn't always show up in performance. Dividend growth funds usually bear less risk, but they usually capture less of the market's upside.

Portfolios focused on dividend income almost always have a value orientation. Value-oriented funds can have merit, but pursuing yield without sufficiently controlling risk can set investors down a dark path. Exhibit 6 shows the relationship between yield and valuation for U.S. dividend income funds at the end of September 2023. The highest-yielding portfolios often trade in the cheapest, and sometimes riskiest, stocks in the market. Those at the bottom of the barrel are there for a reason: The market expects them to grow at a relatively slower pace, if at all. Some of the stocks in these portfolios might be facing existential threats to their business. Their prices may have further to fall, and future dividend payments may get cut if the company decides to preserve cash.

Exhibit 6 The Tight Connection Between Yield and Valuation



Source: Morningstar Direct. Data as of Sept. 30, 2023.

Dividend growth funds typically steer clear of such stocks. They key in on companies with greater profitability and strong competitive advantages that usually translate into better performance during volatile periods. But that stability comes with a caveat: They don't always keep pace with the broader market during rallies. Dividend growth funds typically underperform the market during periods of exceptionally strong growth, when expensive stocks that pay little, if any, dividends fuel the market's rise.

Exhibits 7 and 8 illustrate these trade-offs over two successive five-year periods. Exhibit 7 shows that all three cohorts experienced similar risk between October 2013 and September 2018, as measured by their standard deviation of returns and maximum drawdowns. On the surface, a typical dividend income fund did not look riskier than a dividend growth fund. Meanwhile, a typical dividend growth fund lagged VTI by almost 2 percentage points annualized over this stretch—a period of relatively stable and persistent growth for the broader U.S. market.

The risks baked into the income cohort became more obvious over the ensuing five years, as seen in Exhibit 8. A typical dividend income fund incurred a deeper drawdown during the onset of the coronavirus pandemic in early 2020, despite having a similar standard deviation of returns as a typical dividend growth fund over the five-year period from October 2018 through September 2023. In other words, the relatively risky nature of some dividend income funds won't always show up over shorter time periods, but when it does, it can put a serious dent into a fund's long-term performance.

Exhibit 7 U.S. Dividend Fund Performance From October 2013 Through September 2018

Fund Cohort	Median Total Return	Median Std Dev	Median Max Drawdown
U.S. Dividend Income	10.26	9.17	-9.56
U.S. Dividend Growth and Income	10.88	9.42	-9.63
U.S. Dividend Growth	11.58	9.53	-9.71
Vanguard Total Stock Market ETF VTI	13.44	9.64	-8.84

Source: Morningstar Direct. Data as of Sept. 30, 2023.

Exhibit 8 U.S. Dividend Fund Performance From October 2018 Through September 2023

Fund Cohort	Median Total Return	Median Std Dev	Median Max Drawdown
U.S. Dividend Income	5.58	18.74	-26.76
U.S. Dividend Growth and Income	6.71	18.48	-24.63
U.S. Dividend Growth	8.59	18.37	-23.26
Vanguard Total Stock Market ETF VTI	9.06	19.57	-24.87

Source: Morningstar Direct. Data as of Sept. 30, 2023.

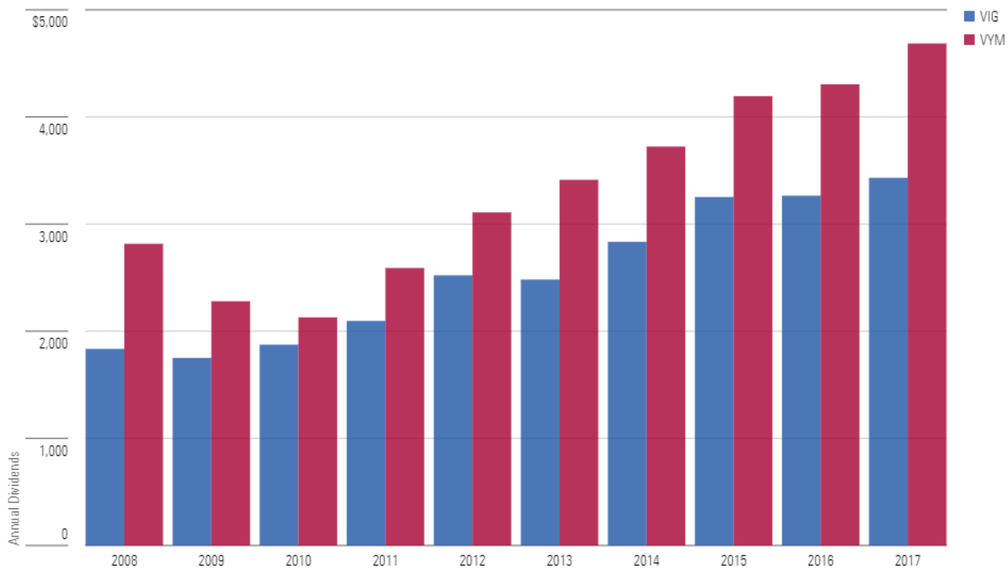
The Big Trade-Off

Dividend funds with significant yields generally attract investors with those income streams. And these investors likely spend most, if not all, of the dividends they receive rather than reinvest them—otherwise there's no point to seeking high income. Meanwhile, the principal investment grows on its own. When this happens, the two components of total return—income and price appreciation—separate from each other. This separation means that total return, which assumes dividends are reinvested, no longer captures the typical investor's experience.

Investors who prioritize yield for immediate spending make a big trade-off between income and price appreciation. All else being equal, higher income typically translates to lower price appreciation. Vanguard Dividend Appreciation ETF VIG and Vanguard High Dividend Yield ETF VYM help illustrate the give-and-take between income return and price appreciation. Both had total returns of about 8.6% over the decade from 2008 to 2017. That said, separating the total return of each fund into income and price appreciation reveals distinct paths toward the same destination.

The end-of-year yield averaged about 2.3% for VIG and a little above 3.2% for VYM, meaning VYM had higher dividend payments in each year. Exhibit 9 shows the annual cash dividends paid by each fund over the same 10-year period on an initial USD 100,000 investment.

Exhibit 9 Annual Dividends Paid on an Initial USD 100,000 Investment



Source: Morningstar Direct. Data as of Sept. 30, 2023.

While VYM came out ahead on its dividend payments, it grew its principal at a slower rate over the same 10 years (assuming an investor spent the dividends and left the principal alone). VYM's initial USD 100,000 appreciated at 5.26 percentage points per year, finishing the decade at USD 167,135, while VIG's price grew at an annual rate of 6.19 percentage points and left an investor with USD 182,189. The 0.90% difference in average yield approximately equaled the annualized difference in price appreciation.

How to Find a Great Dividend Fund

What makes a great dividend fund? Yield, on its own, isn't a great metric to prioritize. Strategies with higher yields usually mean higher price volatility, lower price appreciation, and greater exposure to companies that are likely to cut their dividends. Funds focusing solely on yield often forgo diversification by taking large positions in a few high-yielding segments of the market or concentrating their portfolios in a select few high-yielding stocks. To make matters worse, fund providers often charge higher fees for high-yield portfolios. Collectively, those undesirable traits weigh on a fund's total and risk-adjusted performance.

Instead, well-constructed dividend funds, whether active or passive, should consistently deliver the style that they're attempting to achieve while controlling the risks they take. Income-oriented funds should consistently offer a higher yield than the market, while dividend growth funds should consistently pay and grow their dividends.

The framework that Morningstar uses to rate dividend funds is the same framework applied to rating any fund. Great dividend funds are those set up to deliver strong total and risk-adjusted returns relative to their category index over the long run. Emphasizing total and risk-adjusted returns may not align with an investor’s experience in dividend funds, but it integrates risk management into the evaluation process.

Active and passive funds both have merit. Both approaches can work well, provided the strategy is cost-effective, reasonable, and repeatable and delivers on expectations. With regards to the former, fees are the most important criterion as they directly eat away at a fund’s yield and total return.

Passively Managed Funds

It’s no surprise that the best-in-class index-tracking dividend income and dividend growth funds tend to charge the lowest expense ratios in their respective cohorts. Investors can purchase passively managed dividend income and dividend growth funds charging 0.10% or less for U.S. stocks and 0.25% or less for foreign stocks.

Fees aside, dividends don’t justify taking unrewarded risks, so diversification is another important consideration. A simple guideline for index-tracking portfolios is 100 stocks or more, with one third or less of a portfolio dedicated to its 10 largest positions. Passive funds that persistently bet on single stocks, sectors, or countries (for international funds) have high concentrations and corresponding risks. That usually means avoiding the highest-yielding dividend income funds. Passively managed index-tracking funds represented 17 of the top 20 funds by dividend yield in the U.S. dividend income cohort. But only three of those 17 had 100 holdings or more at the end of September 2023, while the median portfolio held just 59 stocks.

Even well-diversified portfolios may incur risks that can derail their long-term performance or compromise their dividend payments. Great index-tracking strategies often employ rules that steer them away from stocks with deteriorating businesses, such as screening for profitable companies that have a long history of paying consistent dividends or placing greater emphasis on large household names. Troubled companies are more prevalent in dividend income funds with the highest yields.

Annual turnover ratios, which indicate the amount of a portfolio that is bought or sold each year, can highlight funds that are fishing in troubled waters. With few exceptions, great dividend funds typically turn over about 20% to 40% (or less) of their portfolio over the course of a year. Persistently higher turnover ratios likely indicate that a portfolio holds stocks that aren’t making good on their dividend payments, so it must churn through its holdings to chase after those that do.

Exhibits 10 and 11 summarize the Morningstar Medalist Ratings and fees for passively managed dividend funds.

Exhibit 10 Passively Managed U.S. Equity Dividend Funds

Fund	Cohort	Net Expense Ratio (%)	Avg Turnover % (2018 - 22)	# of Stock Holdings	Morningstar Medalist Rating
Fidelity High Dividend ETF	Income	0.29	44	94	Silver
Franklin U.S. Low Volatility High Dividend Index ETF LVHD	Income	0.27	37	125	Silver
WisdomTree US SmallCap Dividend Fund DES	Income	0.38	41	614	Silver
SPDR Russell 1000 Yield Focus ETF ONEY	Income	0.20	42	298	Silver
WisdomTree US LargeCap Dividend Fund DLN	Growth & Income	0.28	15	298	Silver
Vanguard High Dividend ETF VYM	Growth & Income	0.06	10	453	Gold
Schwab US Dividend Equity ETF SCHD	Growth & Income	0.06	30	100	Gold
Vanguard Dividend Appreciation ETF VIG	Growth	0.06	19	314	Gold
FlexShares Quality Dividend Index Fund QDF	Growth	0.37	67	139	Silver

Source: Morningstar Direct. Data as of Sept. 30, 2023.

Exhibit 11 Passively Managed International/Global Equity Dividend Funds

Fund	Cohort	Net Expense Ratio (%)	Avg Turnover % (2018 - 22)	# of Stock Holdings	Morningstar Medalist Rating
Schwab International Dividend Equity ETF SCHY	Income	0.14	N/A	100	Silver
Vanguard International High Dividend Yield Index ETF VYMI	Growth & Income	0.22	16	1,307	Silver
Vanguard International Dividend Appreciation ETF VIGI	Growth	0.15	36	320	Gold

Source: Morningstar Direct. Data as of Sept. 30, 2023.

Actively Managed Funds

Passively managed dividend funds have taken a huge amount of ground from actively managed funds, and for good reasons. Higher fees and less diversified portfolios have undoubtedly driven the decline of actively managed dividend funds. But that doesn't mean they're completely without merit. Some actively managed funds have staying power, and they largely build their advantages around flexibility and aligning portfolios with investor preferences.

Low fees remain critical to long-term performance, and they may be an important consideration when income is the priority. That is, funds may take their fees out of a portfolio's income before they come out of capital growth. If a portfolio has a yield of 2% before expenses and an expense ratio of 1%, the yield gets chopped in half. So, a portfolio with strong-yielding holdings can have slim income when expenses are high.

In some cases, a clear connection exists between fees and the income an investor receives. Exhibit 12 shows the expenses and 2022 income returns of Hartford Equity Income, which currently has Above Average Process and Average People ratings. As the expense ratio rises from the cheap R6 share class to the pricey C shares, the income return, and each share class' corresponding yield, drops in lockstep. The annual income return of the three cheapest share classes ranks in the top quartile of the large-value Morningstar Category, while the more expensive C shares—with the same stock portfolio—fall to the bottom quartile. Passive funds are generally cheaper, so this math plays out across the dividend fund universe.

Exhibit 12 Expense Ratios Bite Into Yield

Share Class	Management Fee (%)	Net Expense Ratio (%)	Difference From R6 Shares	Annual Income Return (2022)	Difference From R6 Shares	Annual Income Return % Rank Cat 2022
Hartford Equity Income R6	0.61	0.65	0.00	2.20	0.00	20
Hartford Equity Income Y	0.61	0.73	0.08	2.12	-0.09	25
Hartford Equity Income I	0.61	0.74	0.09	2.16	-0.04	22
Hartford Equity Income A	0.61	0.97	0.32	1.91	-0.29	34
Hartford Equity Income C	0.61	1.75	1.10	1.15	-1.06	75

Source: Morningstar Direct. Data as of Sept. 30, 2023.

Diversification is another big difference between actively managed and passively managed dividend portfolios. Actively managed funds tend to have narrower portfolios, which presumably puts them at a disadvantage. Economist and Nobel laureate Harry Markowitz summed it up best when he reportedly quipped that "diversification is the only free lunch" in investing. That is, diversification tends to lower volatility with little, if any, drop in returns.

Active managers have their reasons for overseeing portfolios with fewer holdings. Human analysts can only evaluate so many stocks, and managers often prefer to emphasize their top ideas. Exhibit 13 shows the diversification advantage of passive portfolios over their actively managed counterparts in the Morningstar Categories with the most dividend funds.

Exhibit 13 Passively Managed Funds Typically Offer Broader Portfolios

	Median # of Holdings	
Morningstar Category	**Active**	**Passive**
US Fund Large Value	62	104
US Fund Large Blend	56	297
US Fund Global Large-Stock Value	315	108
US Fund Foreign Large Value	62	133

Source: Morningstar Direct. Data as of Sept. 30, 2023.

The tendency isn't law, however, as seen in the global large-stock value category. Still, it's common for passively managed index-tracking portfolios to have roughly double the number of stock holdings as actively managed funds in the same category.

Passively managed index-tracking funds have considerable diversification and low-fee advantages over their actively managed counterparts. But they have a sometimes-important shortcoming. By design, passively managed index-tracking funds rigidly follow a prescribed set of rules, and those rules don't always adapt well to changing market environments, such as a sharp selloff, for instance.

This provides an opportunity for active managers to deliver a superior investor experience. Active managers can modify a portfolio on the fly to keep it aligned with investors' expectations, such as paying out a more predictable dividend yield or keeping the fund's yield above a minimum threshold. As a result, actively managed dividend portfolios have more subtle variations within a given cohort that are difficult to summarize.

Another difference between active and passive funds is the way active managers use dividends to build a portfolio. Active managers sometimes use dividends as a means to achieve a desired risk/reward profile rather than seeking dividend-paying stocks for the income. Some active managers will use historical dividend-growth rates as a measure of quality or profitability. But that's just one criterion they consider. In many cases, a company does not need to have an existing dividend in order to qualify for inclusion in a dividend-oriented portfolio if it carries the ability to pay a dividend today or in the future.

Given the subtleties of actively managed dividend funds, it's best to work from a list of funds that experts have vetted. Exhibits 14 and 15 summarize Morningstar's top-rated dividend funds in the U.S. and international/global groups, respectively.

Exhibit 14 Actively Managed U.S. Equity Dividend Funds

Fund	Cohort	Net Expense Ratio (%)	Avg Turnover % (2018 - 22)	# of Stock Holdings	Morningstar Medalist Rating
Neuberger Berman Equity Income I NBHIX	Income	0.71	43	66	Silver
Hartford Equity Income Y HQIYX	Income	0.73	28	76	Bronze
BlackRock Equity Dividend Instl MADVX	Growth & Income	0.69	42	85	Silver
Fidelity Equity-Income FEQIX	Growth & Income	0.57	33	117	Silver
JPMorgan Equity Income I HLIEX	Growth & Income	0.70	19	83	Silver
T. Rowe Price Equity Income PRFDX	Growth & Income	0.67	19	115	Silver
Vanguard Dividend Growth Inv VDIGX	Growth	0.30	17	42	Gold
T. Rowe Price Dividend Growth PRDGX	Growth	0.64	13	104	Gold
Capital Group Dividend Value ETF CGDV	Growth	0.33	N/A	49	Silver

Source: Morningstar Direct. Data as of Sept. 30, 2023.

Exhibit 15 Actively Managed International/Global Equity Dividend Funds

Fund	Cohort	Net Expense Ratio (%)	Avg Turnover % (2018 - 22)	# of Stock Holdings	Morningstar Medalist Rating
American Funds International Growth and Income F2 IGFFX	Growth	0.65	31	258	Gold
American Funds Capital World Growth & Income A CWGIX	Growth	0.76	34	330	Silver

Source: Morningstar Direct. Data as of Sept. 30, 2023.

Be Your Own Analyst

A simpler way to find great dividend funds is to use a great benchmark that can help gauge the riskiness of others. Income strategies built around high-yielding stocks are inherently risky. So, the growth and income cohort is a better place to find funds that reasonably balance risk and reward.

Gold-rated Vanguard High Dividend Yield ETF VYM and Silver-rated Vanguard International High Dividend Yield ETF VYMI land in the U.S. and international/global growth and income cohorts, respectively. Both have low fees and well-diversified portfolios that have consistently delivered a reasonably higher yield than their respective market. Funds with incrementally higher yields are most likely incurring incrementally greater risks to deliver that yield. Investors should prepare themselves for the possibility of higher volatility and deeper drawdowns as they consider investing in funds with higher yields than VYM or VYMI.

Those seeking active managers also have good options. Silver-rated JPMorgan Equity Income HLIEX is a standout. Like VYM and VYMI, this income-oriented fund strikes a balance between income and sound risk management and lands in the growth and income cohort. Lead manager Clare Hart is retiring in fall 2024 after two decades at the helm, so its People rating recently dropped to Above Average from High. That said, portfolio managers Andy Brandon and David Silberman are seasoned and skilled. They're plying the same High-rated Process that has delivered very steady income, solid defense in down markets, and great long-term total returns.

Vanguard Dividend Appreciation ETF VIG and Vanguard International Dividend Appreciation ETF VIGI are great starting points in assessing dividend growth funds. Both have tended to capture the risk/reward profile that's emblematic of dividend growth portfolios, modestly lagging the domestic and foreign market, respectively, during strong rallies and outperforming during drawdowns. Both funds are cheap within their respective Morningstar Categories, so funds that charge more or turn over their portfolio more frequently will have to take on more risk to overcome those hurdles.

Gold-rated T. Rowe Price Dividend Growth PRDGX, and its ETF version TDVG, are excellent examples of actively managed dividend growth strategies. Manager Tom Huber believes stocks with growing dividends offer outperformance with lower volatility. That's just what this strategy has delivered to investors, outperforming 85% of other dividend growth funds with volatility lower than almost 85% of them over the past decade.

Appendix A

Dividend Fund Search Criteria

Potential dividend funds must come from the following categories:

- Large Blend
- Large Value
- Large Growth
- Mid-Cap Blend
- Mid-Cap Value
- Mid-Cap Growth
- Small Blend
- Small Value
- Small Growth
- Foreign Large Blend
- Foreign Large Value
- Foreign Large Growth
- Foreign Small/Mid Blend
- Foreign Small/Mid Value
- Foreign Small/Mid Growth
- Global Large-Stock Blend
- Global Large-Stock Value
- Global Large-Stock Growth
- Global Small/Mid Stock
- Diversified Emerging Markets

And they must meet the following criteria:

- Strategic Beta Group = "Dividend," OR
- Fund Legal Name contains "Dividend," or "Income," or "Yield," AND
- Fund Legal Name does not contain "option" or "ETN"

Appendix B

Dividend Fund Sorting Rules

Dividend funds were classified into two broad groups based on the market they represent.

The U.S. Group included funds from the following categories:

- Large Blend
- Large Value
- Large Growth
- Mid-Cap Blend
- Mid-Cap Value
- Mid-Cap Growth
- Small Blend
- Small Value
- Small Growth

The International/Global Group included funds from the following categories:

- Foreign Large Blend
- Foreign Large Value
- Foreign Large Growth
- Foreign Small/Mid Blend
- Foreign Small/Mid Value
- Foreign Small/Mid Growth
- Global Large-Stock Blend
- Global Large-Stock Value
- Global Large-Stock Growth
- Global Small/Mid Stock
- Diversified Emerging Markets

Funds in each group were ranked on the following four metrics:

- Average Expected dividend yield
- Average Expected dividend coverage ratio (Expected Earnings / Expected Dividends)
- Average Annualized dividend-growth rate from 2018 through 2022
- Average Profitability (return on invested capital)

Funds with only one of the four metrics were eliminated from the sort.

Each of the remaining funds' rankings were averaged to create a composite ranking.

Funds were sorted into three equally sized cohorts based on their composite ranking. Those within the highest-ranking third were assigned to the dividend growth cohort. Those within the lowest-ranking third were assigned to the dividend income cohort. Funds landing in the middle third represented the dividend growth and income cohort.

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For More Information

Morningstar Manager Research Services
ManagerResearchServices@Morningstar.com

MORNINGSTAR®

22 West Washington Street
Chicago, IL 60602 USA