PRUDENTIAL
INVESTMENT MANAGERS

Prudential Investment Managers

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Grow your wealth with dividends

Every asset has the potential to produce a return. Most of us are familiar with interest, which is the regular return you get on bank deposits, bonds and other investments in the fixed-income space. However, there's another type of return that holds equal importance, but that often gets overlooked, that being dividends from equities. In this article, we take a closer look at what dividends are and the role they play in generating wealth for investors.

Dividends represent a portion of a company's profits or earnings per share and may be paid to shareholders every six months when the company releases its financial results. It is up to the company to decide how much of its earnings to pay to shareholders in form of dividends. Not all companies pay out dividends – young businesses that are still growing often opt to retain their earnings to plough back into the company for further expansion.

Before unit trusts came onto the market, you were considered wealthy if you were able to live off the dividends of a portfolio of shares. The development of unit trusts (that invest in equities) has enabled ordinary investors to also earn dividends. Interestingly, the first unit trust to be launched in the UK was in 1931 by our parent company M&G Investments.

While living off your dividends sounds appealing, for most investors the best course of action is to reinvest them. When you invest in an equity unit trust you can usually choose to have the dividends that you receive from your investment paid out to you in cash, or reinvested in the fund to buy you extra units.

Reinvesting your dividends is often the quickest way to grow your wealth. This is because doing so harnesses the power of compounding, which helps to expand your investment returns exponentially. Compounding occurs when today's returns are added to your capital, and tomorrow's returns are then calculated based on this larger pot of capital. So powerful is reinvesting your dividends that over time, reinvested dividends account for an ever-greater portion of the total value of your investment, as discussed in our article **How to compound your wealth**.

What about taxes?

A major benefit of dividends is that they are typically taxed at a lower rate than income. Currently, they are taxed at 20% as a withholding tax, which means that the tax due is withheld by the company before dividends are paid out. It is then the company's responsibility to pay your dividend withholding tax to SARS. In contrast, any interest you earn is calculated at your marginal income tax rate.

Dividend yield or dividend policy?

You might hear your adviser or other investors discussing the dividend yield of a share. This is simply the dividend expressed as a percentage of the current share price. It's a great way to gauge the dividend income that you can expect to receive from your holdings in a company. Arguably of greater importance, however, is the company's dividend policy, which gives a good indication of how the company plans to utilise its earnings. Some companies gain reputations for being consistent dividend-payers at high rates, which gives them a "defensive" quality in a portfolio that investors can use for diversification purposes.

Such is the importance of dividends in investing, that Prudential offers a fund that focuses on investing in the shares of companies that offer high but also sustainable dividend yields, the **Prudential Dividend Maximiser Fund.** The fund's managers pay particular attention to a company's capacity for generating dividends. As explained in the article A dividend focus pays off there are three key indicators for this: a company's current dividends, its earnings and its book value (the

difference in value between the company’s total assets and total liabilities on its balance sheet). To be included in the fund, a company should score highly on all three of these measures.
As always, the proof of the pudding is in the eating, and the Prudential Dividend Maximiser Fund has certainly demonstrated that its investment strategy pays off. For the year ended 31 July 2021, the fund returned 30.8% (net of fees), outperforming its benchmark, the ASISA South African – Equity – General Category Mean, by 6.2%. Since its inception the fund has returned 16%, outperforming its benchmark by 2.9%.

While dividends might not get the same level of attention as other forms of investment returns, the tax benefits they offer and the compound effect of reinvesting your dividends, make for an appealing option for investors. Investors would do well to consider high-dividend yielding funds, like the Prudential Dividend Maximiser Fund, as part of their investment portfolio.

To benefit from the power of dividends, speak to your financial adviser or invest now by completing an online application form. Alternatively, for more information please contact our Client Services Team on 0860 105 775 or email us at query@prudential.co.za.