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Market Update

30 April 2020

Dividends are normally a reliable indicator of company health. Most of the time, dividends are paid, and are only cut in the direst of circumstances. Company shares frequently suffer very badly when this happens and so during most market crises dividends across the market are very rarely reduced. To put this into context, in 2008 they fell by about 10%, which by historical standards was an exceptional fall.

Most of the time, dividends are maintained even in challenging economic circumstances. However, today we are in an extreme situation and dividends across the market are forecast to be cut by between 30% to possibly as much as 60%. Much of this is dependent on whether the oil majors are going to be able to sustain their dividends, with Shell's decision today to cut their dividend for the first time in 80 years sending a rather ominous message. This makes it very difficult for investors to gauge what a fair market valuation might be as all standard valuation parameters such as earnings and dividends are no longer reliable reference points.

Why are companies cutting dividends? In broad terms, the answer lies in one of three camps. Those companies which find themselves in the forefront of the economic collapse, such as hoteliers, travel businesses and hospitality industries, are being forced to cut dividends. They simply do not have the money to be able to pay-out to shareholders. Other companies are perhaps less affected by the Covid-19 outbreak, but nevertheless feel it is prudent to retain cash on their own balance sheets rather than to distribute it to shareholders. This is a precautionary measure to ensure that the business can be sustained and will not have to turn to shareholders for additional funding through the likes of rights issues. Thirdly, certain businesses have been forbidden from making dividend payments by the regulator, namely banks. They have a regulatory obligation to ensure that they remain fully capitalised and in the best possible health to guarantee that they are able to distribute capital and loans to industry across the UK.

All this means is that investors who are looking for a consistent income from their investments will, at least in the short term, be disappointed. Therefore, they may need to look towards other areas for their income requirements or potentially take income from their capital depending upon their individual needs