

Total Return: Income and Price Change

April 28, 2024

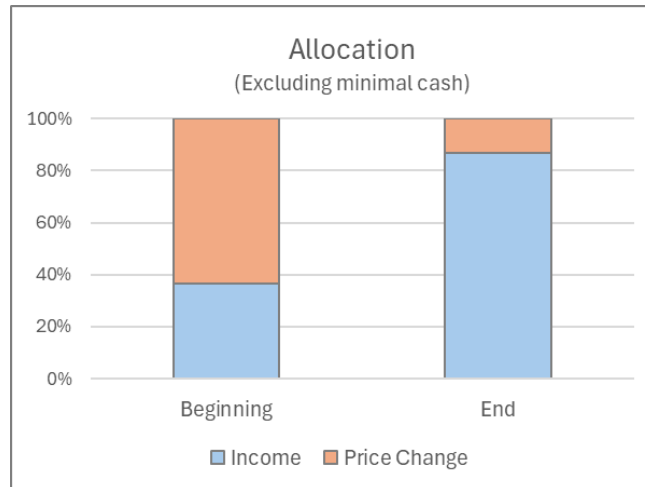
Successful investing is all about allocation. The first level allocation is between debt and equity, between loaning and owning. This is often framed as between bonds and stocks, although our preferred stocks are debt, and we have a significant allocation to high-yield companies whose business is debt.

For this analysis beginning with 2020 and running through the first quarter of 2024, I contrast holdings with a primary goal being income and those with a primary goal being gain from price increases. Surprisingly, I have not found software that charts Total Return split between income and price change. It took considerable data transformations to get what I was looking for and what is presented below.

I show the same data on different charts because different perspectives looking at the data lead to different perspectives on the implications.

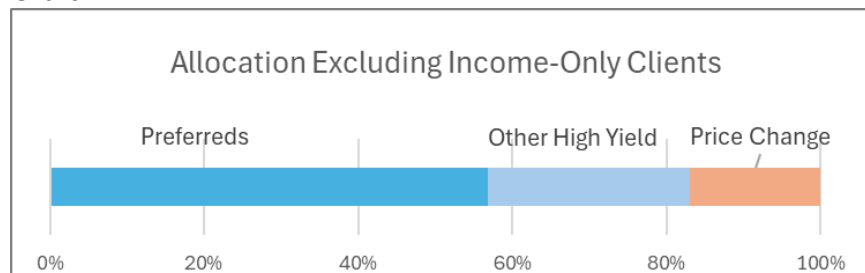
Our allocation has shifted dramatically towards income.

Chart 1.



The shift towards income has been accentuated by new clients who have invited me to specifically manage for income. Excluding the income-only clients, here is the allocation:

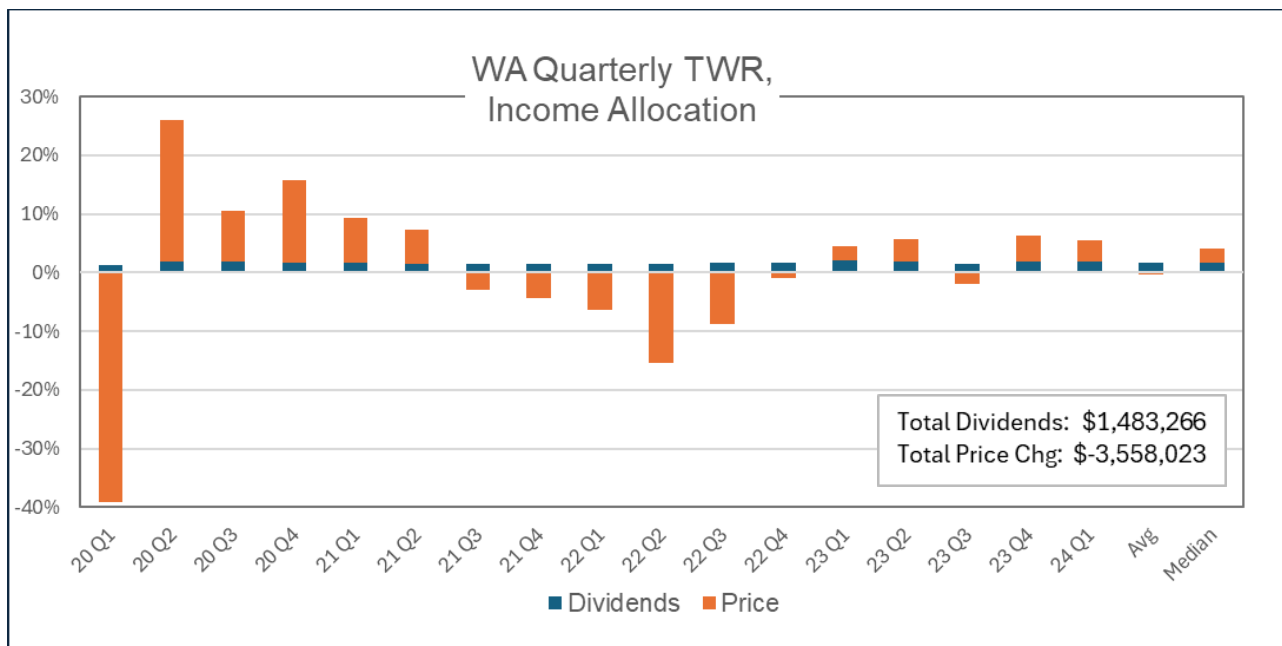
Chart 2.



About 25% of the dollars I manage are held by income-only client allocations, with clients managing their equity allocations. I'm surprised by the similarity in Charts 1 and 2.

The purpose of this analysis is to judge if such a high allocation to income is justified. We will look at relative returns and volatility.

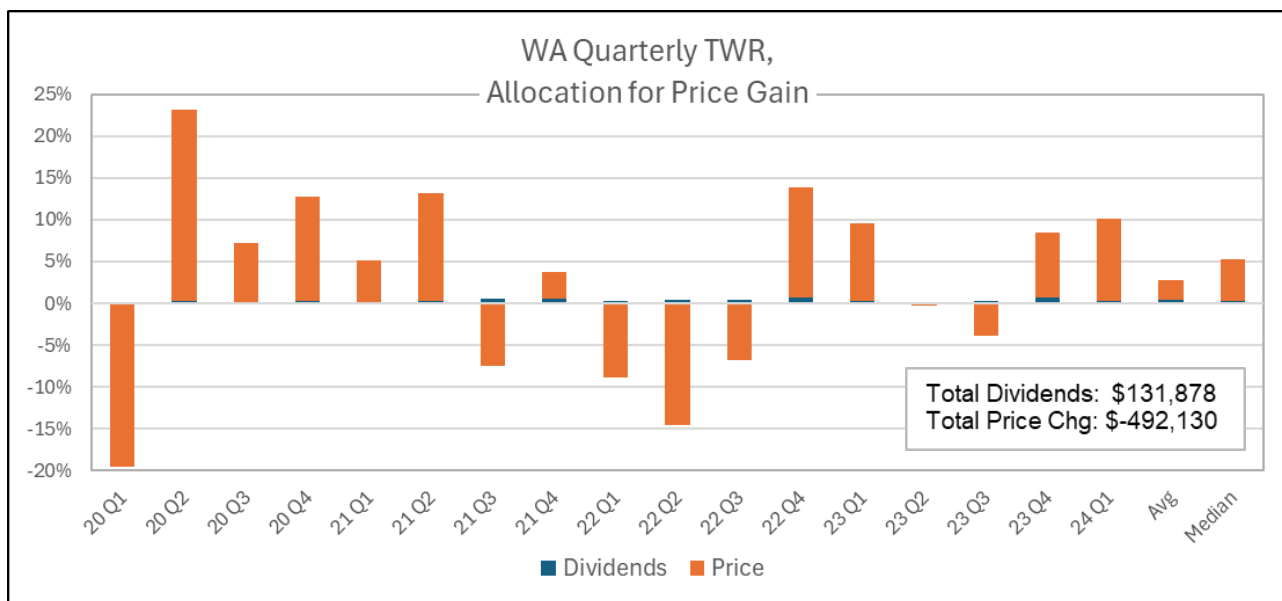
Chart 3. Histogram: Wenzel Analytics Income Allocation



	20 Q1	20 Q2	20 Q3	20 Q4	21 Q1	21 Q2	21 Q3	21 Q4	22 Q1	22 Q2	22 Q3	22 Q4	23 Q1	23 Q2	23 Q3	23 Q4	24 Q1	Avg	Median
Dividends	1.3%	1.8%	1.8%	1.7%	1.7%	1.5%	1.5%	1.5%	1.4%	1.4%	1.7%	1.7%	2.0%	1.8%	1.6%	1.9%	1.9%	1.7%	1.7%
Price	-39.1%	24.1%	8.7%	14.0%	7.7%	5.8%	-3.0%	-4.3%	-6.4%	-15.4%	-8.9%	-0.8%	2.4%	3.9%	-2.0%	4.3%	3.5%	-0.3%	2.4%
TWR	-37.8%	25.9%	10.5%	15.7%	9.4%	7.3%	-1.5%	-2.8%	-5.0%	-14.0%	-7.2%	0.9%	4.4%	5.7%	-0.4%	6.2%	5.4%	1.3%	4.4%

The rates in the tables are quarterly changes (TWR) and not annual rates.

Chart 4. Histogram: Wenzel Analytics Allocation for Goal of Gains from Price Change.



	20 Q1	20 Q2	20 Q3	20 Q4	21 Q1	21 Q2	21 Q3	21 Q4	22 Q1	22 Q2	22 Q3	22 Q4	23 Q1	23 Q2	23 Q3	23 Q4	24 Q1	Avg	Median
Dividends	0.2%	0.2%	0.1%	0.3%	0.1%	0.3%	0.6%	0.5%	0.3%	0.4%	0.5%	0.7%	0.3%	0.1%	0.3%	0.8%	0.3%	0.4%	0.3%
Price	-19.6%	23.0%	7.1%	12.5%	5.0%	12.9%	-7.5%	3.3%	-8.8%	-14.6%	-6.8%	13.1%	9.2%	-0.3%	-3.9%	7.7%	9.8%	2.5%	5.0%
TWR	-19.40%	23.20%	7.20%	12.80%	5.10%	13.20%	-6.90%	3.80%	-8.50%	-14.20%	-6.30%	13.80%	9.50%	-0.20%	-3.60%	8.50%	10.10%	2.8%	5.1%

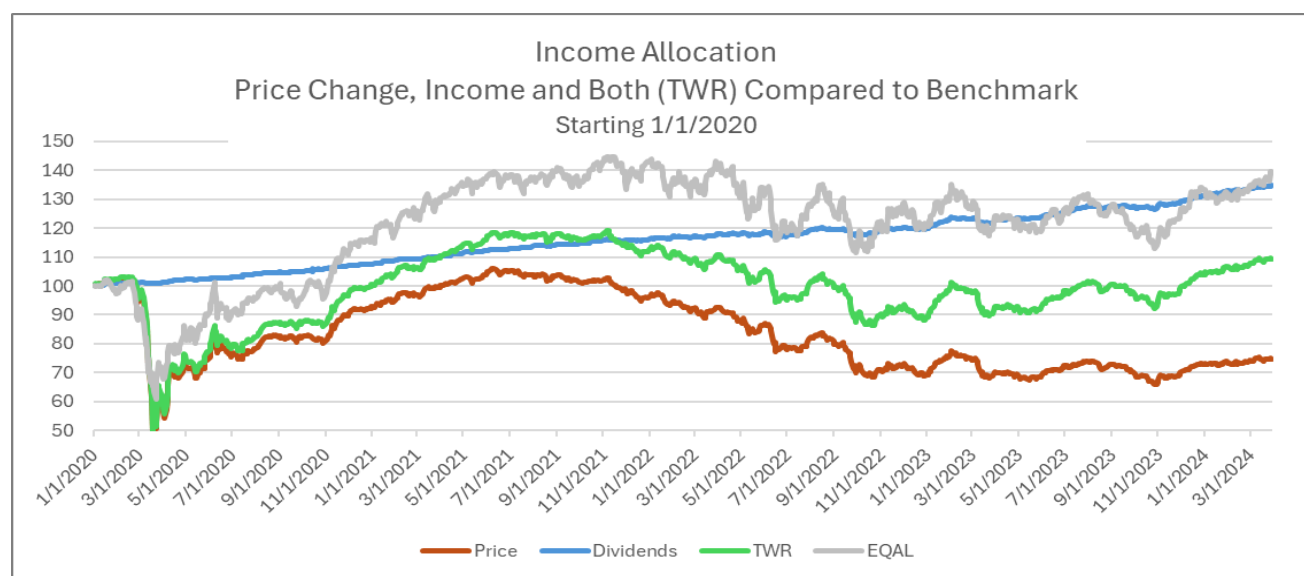
Note the dramatic difference between the quarterly averages and medians for price appreciation in both allocation strategies. A standard deviation would tell us the same story.

The quarterly bars reflecting quarterly returns for more than four years make the dividends (in blue) look inconsequential. Yet when I added them up for the goal of appreciation, they came to \$131,878 while the net price change for each quarter came to \$-492,130.

Obviously, the dividend income is cash received, while the price change is merely hypothetical if one had bought at the beginning of each quarter and sold at the end. The orange bars only matter if we sell, or for reinvesting the dividends. For the income allocation shown in Chart 3, any withdrawals were made from dividend income. The price drops had no impact on income except for reinvestment bargains.

For a different perspective, we turn now to daily, cumulative line charts.

Chart 5. Daily Cumulative Chart: Wenzel Analytics Income Allocation

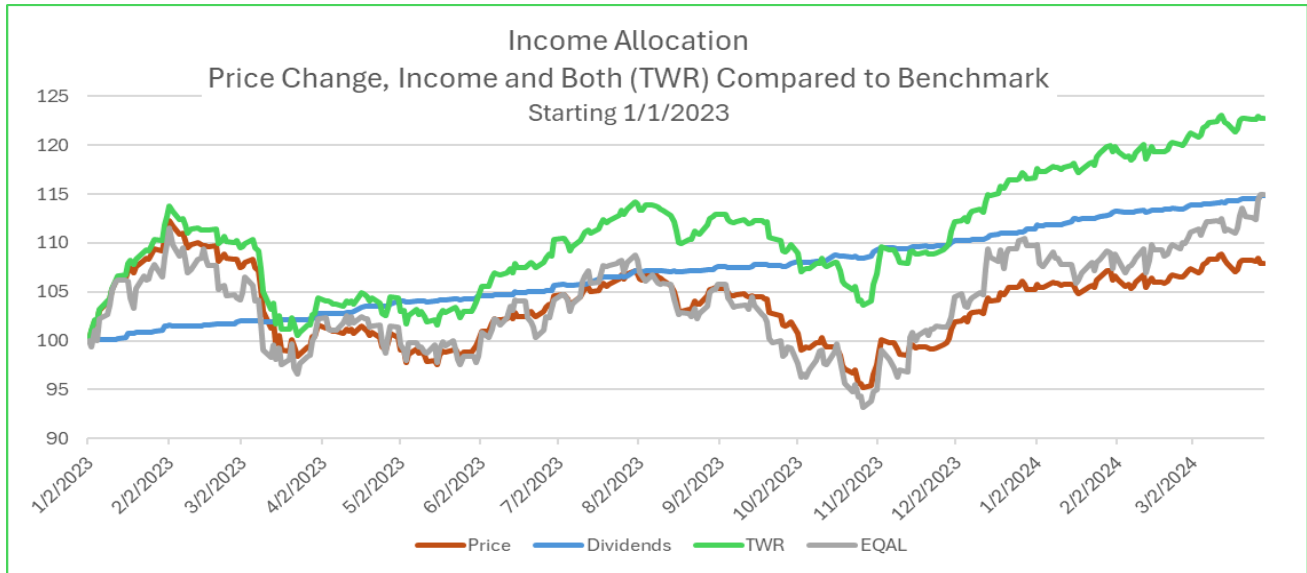


The blue line is the cumulative income or dividends. Obviously, this is cash received or realized returns. It was either reinvested in new positions or withdrawn for living expenses. For the time period reviewed, income ended up about the same as the gray line of Total Return for the Equal-Weighted Russell 1000 benchmark. The benchmark was hypothetical in that it represents unrealized returns.

The bottom orange line is the change in the trading price for the income allocation positions. The green line midway combines the blue dividends line and the bottom orange price line to give Total Return.

Over this time period the Income portfolio had a significant price decline and significantly trailed the benchmark. However, contrary to common reactions, this was advantageous for our investors since nothing was being sold at the depressed prices, and we were able to reinvest the dividends at discounted prices.

Chart 6. Five Quarters, Daily: Wenzel Analytics Income Allocation



If we zoom in to just the last five quarters, we get a different picture. Again, the income about matches the Total Return of the benchmark. However, here the price of the income portfolios matches the benchmark up until the last quarter, with an end result of Total Return on the income portfolios surpassing the benchmark by about 8% over the five quarters.

At the end of the first quarter, 2024, we held 1,036 preferred stocks with a median market price of \$20.54 (average of \$17.86). The call price is \$25 per share for a gain upon call of 22% above the median. (This is not an annual return, as it is indeterminate when a call might occur.)

What observations or conclusions would you draw from charts 5 and 6?

We turn now to the same charts but for portfolios targeted for price gains rather than income.

Chart 7. Wenzel Analytics: Gains Allocation

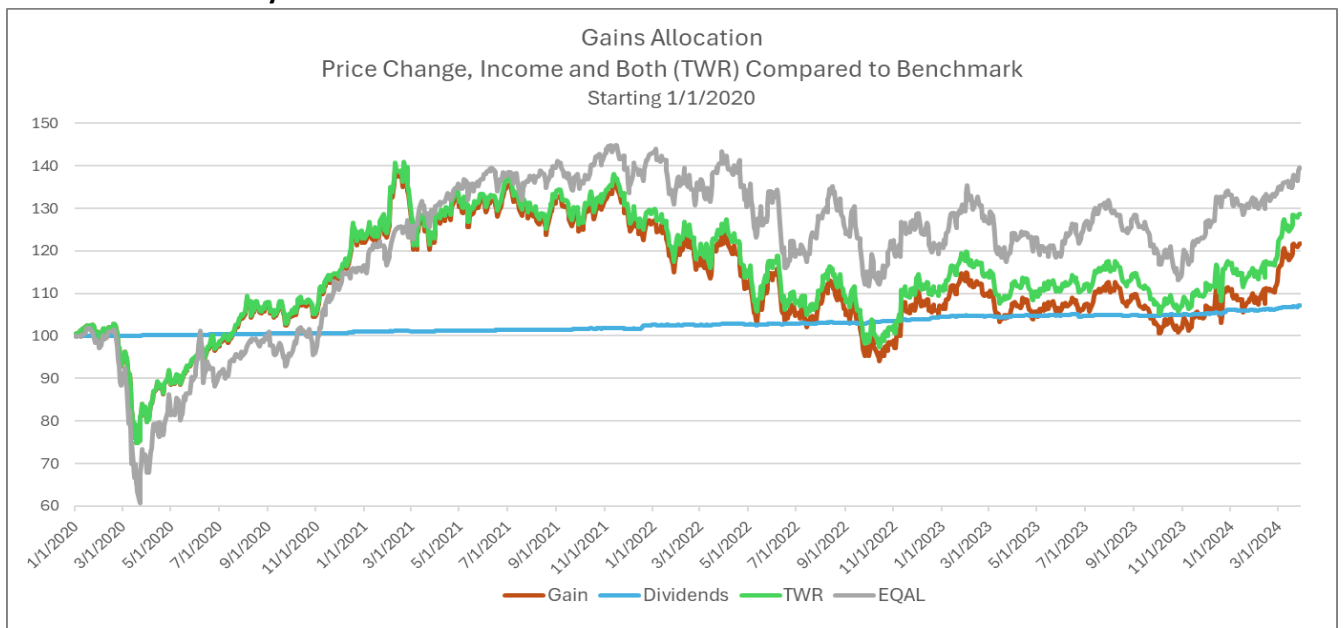
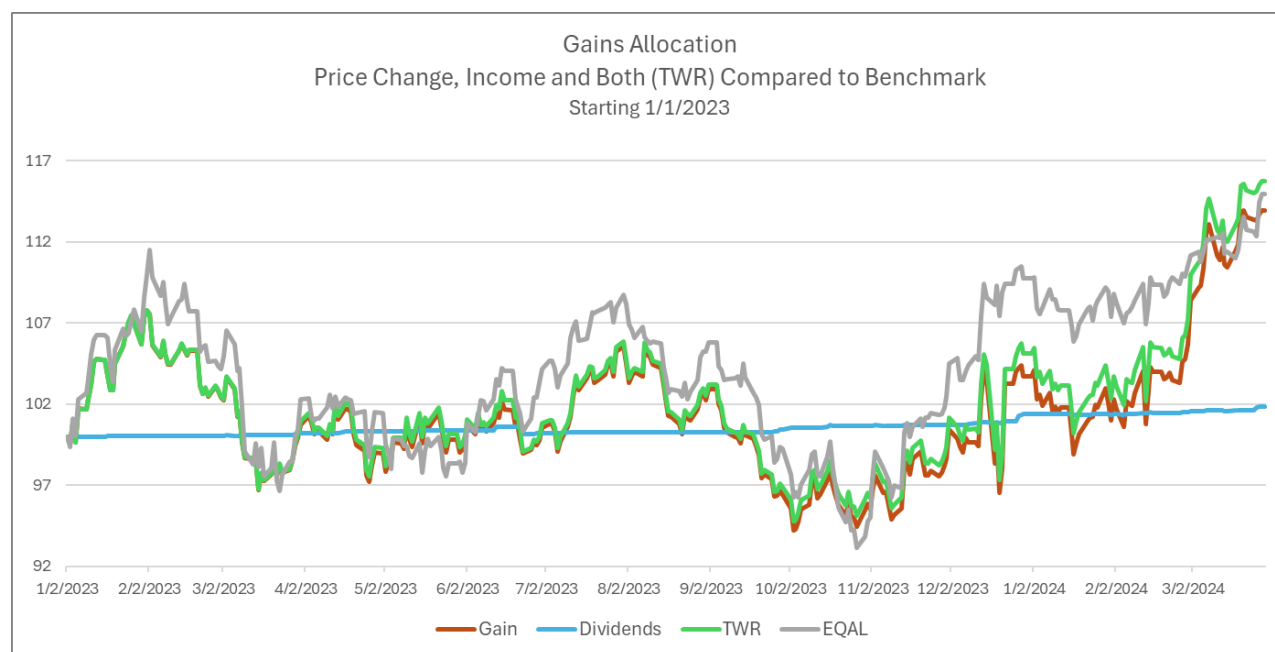


Chart 7 has the same metrics applied to the other part of our allocation, that being where the goal was for price gains rather than for income. The blue income line amounted to about 8% over the seventeen quarters or about 2% a year. Even with the income and price gains the Total Return was short of the EQAL benchmark. This reflects a long-term weighting to value, small-caps and emerging markets.

The Total Return of about 29% compared to about 10% for the Income allocation. Does that negate the value of the disproportionately high allocation to Income? Before deciding we will look at the shorter time frame, and review what other factors should be considered.

Chart 8. Wenzel Analytics Gains Allocation, Shorter Time Frame



Note that the scale is different on each chart.

Over the last five quarters returns with a goal of price appreciation about matched the benchmark. The Total Return for the five quarters was about 16% compared to 23% for the Income allocation. Does that support the value of the disproportionately high allocation to Income?

Concluding Analysis

The full period under study included a bull market and higher interest rates. How does that affect judgments about the efficacy of this particular Income allocation relative to a price gains allocation?

What are the merits of the histogram bar charts relative to the cumulative line charts?

A typical "dividend strategy" consolidates the dichotomy presented here, frequently with a goal of three to four percent dividends plus price appreciation. I think that merely muddies the strategy and yields lower overall returns with unacceptable vulnerability to volatility. What do you think? Typically Total Return is measured, while the underlying contributions/impairments of income and price change are not very visible.

We are able to achieve extraordinarily high dividends by buying preferred stocks which have low liquidity. The market cap of these positions would be considered micro-cap. If it works well for us with debt, could we also achieve above market returns with micro-cap, low-liquidity equity positions?

More than half the publicly traded stocks are too small to be in the Russell 2000. Stock Investor Pro, a data service, lists 6,800 stocks. The market capitalization of the 3,800 stocks smaller than the largest 3000 (Russell 3000) comprises 0.63% of the total market capitalization. I doubt if any of these 3,800 stocks are followed by an analyst. Might there be opportunities there?

The search for price gains or taking consistent income is a race between the hare and the turtle. How important is it to know with a high degree of certainty what the income will be for next year? How does one get over fretting about market and price changes and instead watch the dividend dollars coming in?

Our thinking (and feeling) is channeled by the data we observe. How do we structure our reporting to give an appropriate comparison between income and price changes?

Do returns matter? When people ask what I do, they typically respond by telling me what a nice person they have for an advisor, as if I was asking them to become my client. No one has ever mentioned the returns provided by their financial advisor.