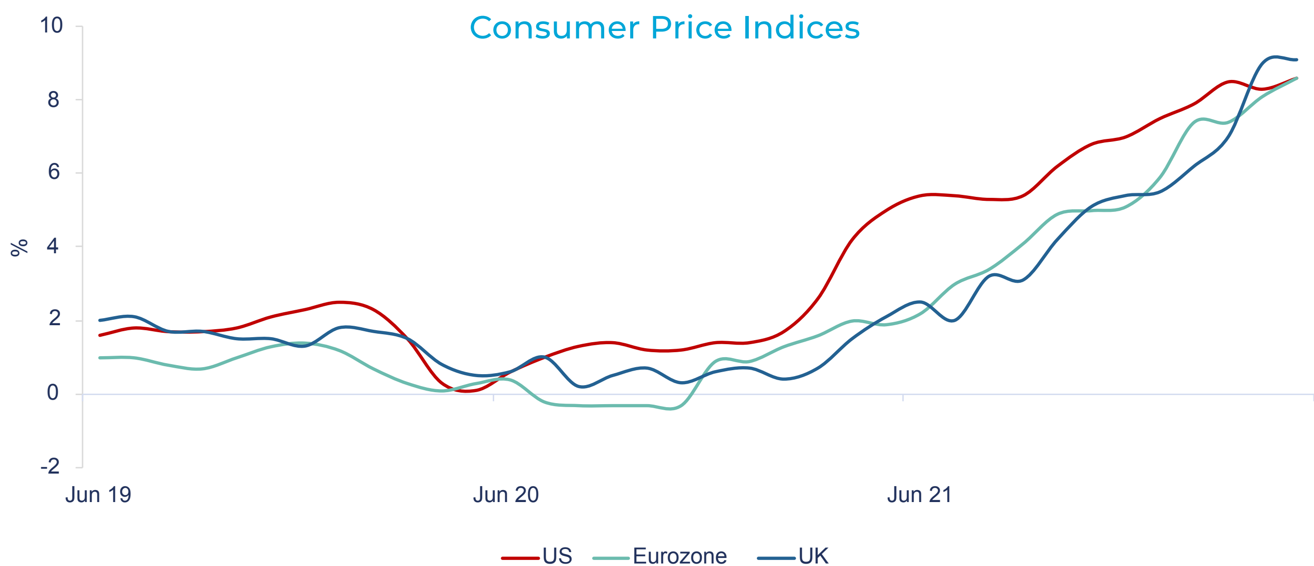
SmartETFs

DIVS

Review of Q2 2022
& Why Dividends *Still* Matter

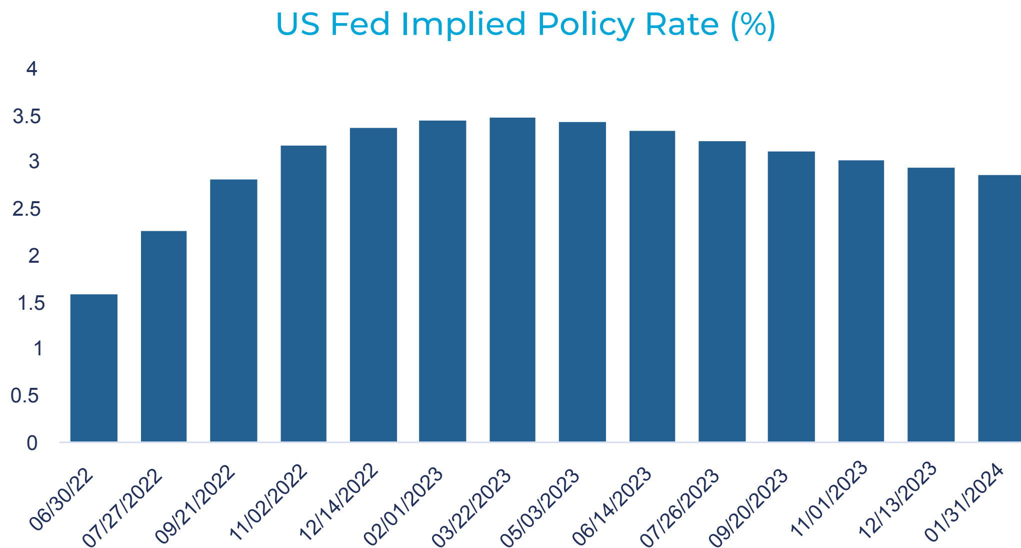
Review of Q2 2022

The second quarter of 2022 was a continuation of many of the themes exhibited in the first quarter with inflation the main concern on investor's minds. Indeed, inflation continued to climb to decade-highs across developed markets, with the US reaching 8.6% in May while the Eurozone reached 8.1%. While inflation is a global issue, it is important to note the regional differences driving these headline numbers; in the US, wage growth continued to be a significant factor with the latest figures at 5.1%, whereas in Europe and the UK, commodity prices (principally energy and food) have continued to climb, exacerbated by Russia's invasion of Ukraine, and have been the primary inflationary driver.



Source: Bloomberg. Data as of June 30, 2022

In response to the global issue of inflation, central banks have continued to tighten monetary policies, realizing a stark change in opinion – most notably the Fed which retired their labelling of inflation as "transitory". The market is now focused on how fast and how aggressive central banks will be. Indeed, over the quarter, the Fed continued to be reactive to new data, raising rates by 75 basis points (bps) to 1.75%, the largest rate hike since 1994. With this, the market now expects rates in the US to rise to over 3% by year-end – a significant acceleration from the <1% policy rate markets had expected at the end of 2022.



Source: Bloomberg. Data as of June 30, 2022

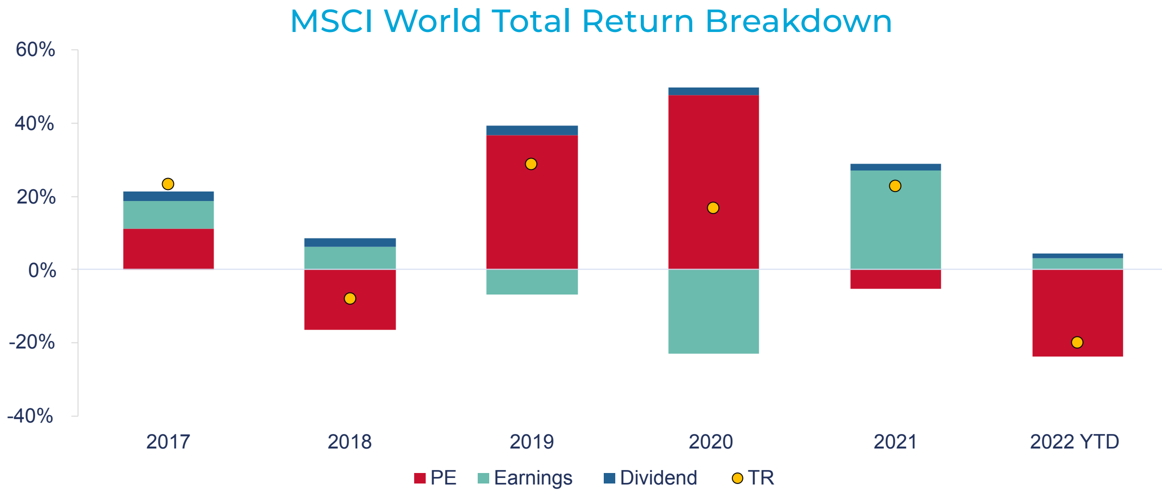
With this increasingly aggressive stance that central banks are having to take to control inflation, investors are progressively more worried that tighter monetary policies will push economies into recession. While analysts have generally been positive on earnings upgrades year-to-date, recessionary concerns are beginning to cause these to flatten and, in some regions, trend down.

Where we are today

In assessing the current market environment, it is useful to contextualize it with the drivers of performance over the last 2 years. Indeed, over 2020, when the MSCI World finished the year +16.5% (USD), multiple expansion drove this positive return as investors were willing to look through near-term negative earnings inflicted by COVID to a recovery. Contrasting this, in 2021, another strong year for markets with MSCI World up 22.4% (USD), markets were driven by earnings upgrades while multiples broadly contracted. Here, with the onset of new variants and heightened uncertainty, the market rewarded companies that could successfully grow their bottom-line.

Finally, looking at 2022 thus far, we have seen a continuation in multiple contraction as central banks have ramped up their monetary tightening policies, but we have not seen analyst earnings estimates decline against this backdrop of potentially slowing growth. Multiple contraction has therefore been the primary driver of the negative market performance YTD. However, with recessionary fears on the rise, the risk now is that earnings expectations will need to begin to trend down – something the upcoming earnings season, and company forward guidance, will influence heavily.

While it is not obvious in which direction the economy will proceed (and, for example, even if we can agree a recession is likely – which we are



Source: Bloomberg. Data as of June 30, 2022

not necessarily saying is inevitable – then one must also determine if it is a "deep" recession or a "light" recession to determine successfully which companies will do better or worse), it seems more likely we are now in a period of lower growth. We believe this highlights the importance of DIVS' approach - investing in high-quality businesses that have proven their ability to maintain high returns on capital across market cycles, that in many cases have strong pricing power with which they can pass on rising costs, and robust balance sheets which should insulate them from both the rising costs of debt and any more pronounced market volatility.

Indeed, in the most recent drawdown (01/04/2022 – 06/17/2022), the Fund outperformed the MSCI World Index by 7.0% (in USD) - continuing the Fund's historic trend of outperforming in significant market falls since the Fund was launched at the end of 2010.

Performance as of 6/30/2022	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception (03/30/2012)
DIVS at NAV	-13.14%	-4.93%	9.92%	9.60%	10.33%	9.83%
DIVS at Market Price	-12.71%	-4.63%	10.06%	9.68%	10.38%	9.87%
MSCI World NR	-20.51%	-14.34%	6.99%	7.66%	9.51%	8.71%

Expense Ratio: 0.65% (net) | 1.08% (gross)

Performance data quoted represents past performance and does not guarantee future results. The investment return and principal value of an investment in the Fund will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance of the Fund may be lower or higher than the performance data quoted. Performance data current to the most recent month-end may be obtained by visiting SmartETFs.com, or calling (866) 307-5990. The returns shown are cumulative for the period, not annualized. Market prices return is based on the market price of Fund shares as of the close of trading on the exchange where the shares are listed.

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Why Dividends *Still* Matter

Taking a step back, we think it is helpful to emphasize once again the importance of dividend investing, particularly in lower growth environments. Taking data from a paper we wrote after launching the Fund, and which we revisited in April 2020, called Why Dividends (Still) Matter, we first assess the importance of dividends to the total return an equity investor receives over long periods. Specifically, from the table below, we see across the various decades from the 1940s, dividends accounted for, on average, 48.9% of total returns in the S&P500 index. However, when we look at the two lower growth decades - the 1940s and 1970s - we see dividends played an even greater role, on average contributing over 75% of total returns. Even in high growth decades such as the 1990s or 2010s dividends still accounted for over 25% of the overall total return.

S&P 500 Returns for Individual Decades since 1940

	Total return	Price appreciation	Dividends	Dividends as % of total return	
1940s	**143.1%**	34.8%	108.3%	75.7%	Low growth
1950s	**467.4%**	256.7%	210.7%	45.1%	
1960s	**109.5%**	53.7%	55.8%	51.0%	
1970s	**76.9%**	17.2%	59.7%	77.6%	Low growth
1980s	**389.2%**	227.4%	161.8%	41.6%	
1990s	**423.2%**	315.7%	107.5%	25.4%	High growth
2000s	**-9.1%**	-24.1%	15.0%	*Not meaningful*	
2010s	**256.4%**	189.7%	66.7%	*26.0%*	High growth
Average	***232.1%***	***133.9%***	***98.2%***	***48.9%***	

Source: “Why Dividends (Still) Matter”, Guinness Atkinson Funds

The driving force behind this is the relative stability of dividend payments compared to earnings. Below we see that across 5 US recessionary periods, earnings-per-share (EPS) dropped peak to trough by an average 42%. This is in stark contrast to dividends-per-share (DPS), which only dropped on average 8%.

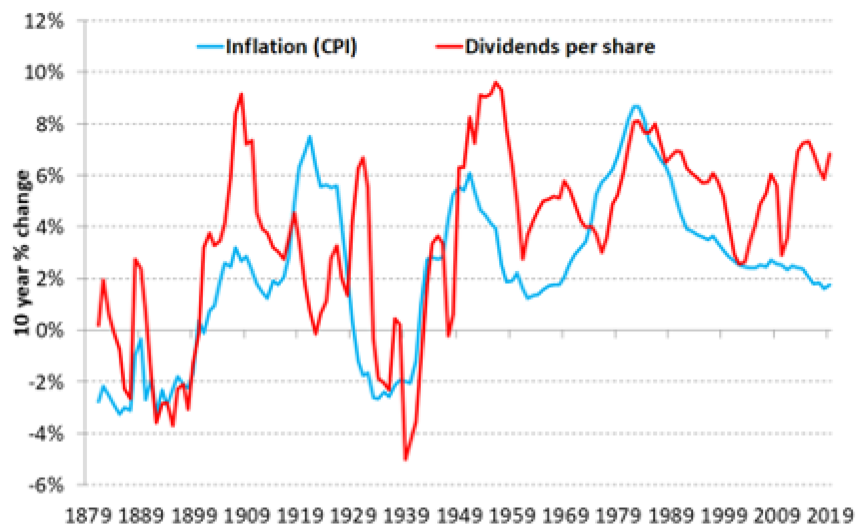
S&P 500 DPS & EPS Falls in the Last 5 US Recessionary Periods

US Recessionary period	Dividend per share (DPS) trough date	Earnings per share (EPS) trough date	Peak to trough (%)	
			DPS	EPS
Nov 1973 to Feb 1975	Dec 1975	Sep 1975	-1%	-15%
Jul 1981 to Oct 1982	No decline in DPS	Mar 1983	-	-19%
Jul 1990 to Feb 1991	Dec 1991	Jun 1992	-1%	-32%
Mar 2001 to Oct 2001	Jun 2001	Dec 2001	-6%	-54%
Dec 2007 to May 2009	Mar 2009	Mar 2009	-24%	-92%
Average			**-8%**	**-42%**

Source: "Why Dividends (Still) Matter", Guinness Atkinson Funds

We also note that over long periods, the growth in dividends matches, and often exceeds, that of inflation – suggesting that the income stream from dividend payments can be maintained in real terms.

Rolling 10-year Growth in Inflation (CPI) & S&P 500 Dividends per Share
January 1881 to January 2019



Source: Robert J. Shiller, stock market data used in "Irrational Exuberance" Princeton University Press, Guinness Atkinson Funds

To conclude we would summarize that, historically, dividends have:

- Delivered an even greater proportion of total return in periods of low growth
- Delivered an income stream that is much more consistent than that of company earnings
- Grown at a rate equal or above that of inflation over the longer-term

As such, we believe there is a good argument for dividend investing in the current market environment. We would caution, however, that not all dividends are created equally. We note that "high yield" stocks and sectors can perform poorly in market sell offs, and particularly in recessionary environments, as these companies can often be more economically sensitive or more highly regulated (such as banks, where we have seen many instances of dividend payments being curtailed by regulators or the influence of governments). In this scenario we believe the case for quality, growing dividends may be more compelling: they are less likely to cut, they may protect better in a downturn, and often have better prospects for stable/sustainable earnings growth alongside.

Important Information

MSCI World Index captures large and mid cap representation across 23 Developed Markets countries. With 1,583 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

Basis Points (BPS) refers to a common unit of measure for percentages in finance. One basis point is equal to 1/100th of 1%, or 0.01%, or 0.0001, and is used to denote the percentage change in a financial instrument.

S&P 500 is a market-capitalization-weighted index of 500 leading publicly traded companies in the United States.

Investors cannot invest directly in an index.

Earnings Per Share (EPS) is calculated as a company's profit divided by the outstanding shares of its common stock. The resulting number serves as an indicator of a company's profitability.

The Fund invests in securities that pay dividends, and there is no guarantee that the securities held by the Fund will declare or pay dividends in the future, or that dividends will remain at current levels or increase. Investments in foreign securities involve greater volatility, political, economic and currency risks and differences in accounting methods. These risks are greater for emerging markets countries. Investing in securities involves risk and there is no guarantee of principal.

Consider the investment objectives, risks, charges, and expenses of the Fund carefully before investing. For a prospectus or summary prospectus with this and other information, please call (866) 307-5990 or visit our website at www.SmartETFs.com. Read the prospectus or summary prospectus carefully before investing.

Shares of the Fund are distributed by Foreside Fund Services, LLC