You don’t have to be Einstein to appreciate the appeal of dividends

More than 70 years after his death, Albert Einstein’s standing as an intellectual titan remains undimmed. A curious corollary of the supreme regard in which he’s still rightly held is that he’s routinely credited with wise remarks that he arguably never uttered in his life.

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There’s one in particular that’s frequently trotted out in investment circles: “Compound interest is the eighth wonder of the world. He who understands it earns it; he who doesn’t pays it.”

Some scholars question whether the great man ever offered this snippet of wisdom, but let’s not worry unduly about that. What matters is that the statement has no mean merit.

The fact is that compound interest *is* pretty wonderful. It’s perhaps not as instantly inspiring as the Great Pyramid of Giza or the Hanging Gardens of Babylon, granted, but it’s undeniably attractive over the long term.

This is why investors should be fully aware of the benefits of dividend income. The appeal of investing – and, crucially, *re*investing – in companies that deliver regular dividends to shareholders has perhaps become somewhat overlooked in recent years, but it shouldn’t be ignored today.

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To truly understand why, let’s first wind back to the aftermath of the global financial crisis. Central banks responded to the chaos with a raft of quantitative easing (QE) programmes, which led to cheap debt and so encouraged enormous investment in expected growth.

The result was a lengthy period in which many businesses weren’t exactly laser-focused on the efficient allocation of capital. They didn’t need to be, because borrowing was so inexpensive. They merrily burnt through cash instead of giving some of it back to their investors.

Against this backdrop, dividends made only a relatively small contribution to total investment returns. But it’s vital to note that this was a historical anomaly. When QE is off the table – as is the case now – dividends tend to play a much more significant role.

First of all, dividend income brings a measure of dependability – both in good times and bad. It's a form of reassurance – a sign that you've invested in companies that are enjoying steady growth and are able to consistently distribute a healthy slice of their profits to shareholders.

Crucially, this demonstrates discipline. It shows a business's management team isn't cut from the cash-burning cloth and is instead determined to plot a sensible course towards continued success over the long term.

Ideally, a team will begin the year with a certain dividend in mind. This will be paid out in cash from real earnings, with what's left of the company's budget allocated accordingly.

Naturally, there are instances when businesses might channel funds elsewhere. Fair enough. But we're very wary of those that merely throw their profits around in an ill-advised bid to somehow come up with the Next Big Thing. Reliability is what counts.

So what about the compounding element? Some investors prefer to live off their dividend income, but others plough it back in – and that's when "the most powerful force in the universe", as Einstein allegedly also described it, comes into effect.

By way of illustration, consider the performance of the US's S&P 500 between 1926, when the index's first incarnation was launched, and February this year. Dividends contributed approximately 31% of the total return across this timeframe, exceeding 50% in three individual decades[1].

This in itself is all well and good, but now let's add compounding to the mix. It's at this point that the figures become really striking.

In this case we apply a start date of January 1 1930, when the S&P 500's index level was 1. From there, according to S&P's own research[2], the *price* return – that is, the simple change in the value of an investment – reached 278 by February 2025.

Meanwhile, the *total* return – that is, with reinvested dividends factored in – reached 9,584. That's quite a difference, to say the least – a powerful testament to the wonder of which Einstein purportedly spoke.

Finding the brightest sources of dividend income isn't as easy as some people might imagine. For example, it's not merely a question of stuffing a portfolio with the highest-yielding stocks, since companies that muster big payouts one year often conspicuously cut their dividends the next.

Businesses that pay prudent dividends and look to grow them consistently are usually likely to represent a more attractive prospect. Some eventually earn the title of "dividend aristocrat", a term used for a company that raises its dividend for a number of consecutive years (the precise number varies by index).

We believe the best way of identifying the dividend stars of today and tomorrow is through a combination of fundamental and qualitative analysis. This allows us to arrive at fully informed investment decisions.

Ultimately, dividends can act as a valuable source of certainty. In *un*certain times, including a low-growth and high-inflation environment, this is an especially desirable quality – one that reminds us all of another sage maxim for which Einstein is customarily credited: "In the middle of difficulty lies opportunity."

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1. See, for example, S&P 500 Dow Jones Indices: S&P 500 Dividend Aristocrats: The Importance of Stable Dividend Income, March 2025 – www.spglobal.com/spdji/en/documents/research/research-sp500-dividend-aristocrats.pdf.
2. Ibid.

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