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Research paper



Lure of dividend yields the case of 20 dividend stocks in Malaysia

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Abstract

Following the 2016 prevailing negative interest rates in some advanced economies, Malaysia high-yielding dividend stocks could emerge as a new asylum for both foreign and local investors who seeking good returns. Rationale portfolio investors enjoy returns when stocks' prices appreciate and provided dividend yields are still attractive, particularly in large-cap dividend (income) stocks. Large-cap dividend stocks would get rerated as efficient and optimal portfolio as more foreign funds flow into them. Conversely, small-to mid-cap dividend stocks below RM1 billion market capitalization are also worth investing. When the market moves, smaller cap companies will obtain a higher leverage in the light of price movement. By investigating the 20 Malaysian dividend stocks that would sustain the risk adjusted performance measure, these portfolio will be compared, analysed and ranked relatively by utilizing the correlation-covariance methodology and the Sharpe Index. The REITs are able to provide higher cash dividend pay-outs and favoured an optimal portfolio selection. Given a greater local market exposure, fuelled by domestic demographics and rising middle class, small-cap dividend stocks will still be new safe havens to both local and foreign institutional funds.

Keywords: *Large-Cap Dividend Stocks; Small-to Mid-Cap Dividend Stocks; Efficient and Optimal Portfolio; Correlation; Sharpe Ratio.*

1. Introduction

Investors are gravitating towards emerging market debt due to the ability to pick up additional yield relative to developed-markets debt (Daly, 2017). In recent years, banks pushed policy rates negative which include two big giants – the European Central Bank (ECB) in June 2014, and the Bank of Japan (BOJ) in January, 2016. Central banks in Denmark, Switzerland and Sweden have also implemented negative interest rates, with the believe adopting sub-zero rates would spur sluggish economies. Given the negative interest rates in in many western economies, high-yielding dividend stocks could turn out to be new safe havens for foreign and local investors seeking good returns. Some Bursa-listed stocks are offering dividends as high as 7% per annum (see Table 1). The prevailing negative interest rates for some advanced markets have reignited the attractiveness of emerging markets, including Malaysia (Clint & Ho, 2016).

According to MIDF (Malaysian Industrial Development Finance Berhad), year-to-date (as in May, 2016) net inflows from foreign investors were RM5.34bil, against a net outflow of RM19.5bil in 2015 and RM6.9bil in 2014. Rational investors who hunt for higher yields may assess the defensive stocks with stable cash flows and decent dividend yields. Similarly, high-yielding stocks appeal to foreign portfolio investors who adopt a more defensive approach of investing. Initiatives to cut interest rates deeper may accelerate portfolio inflows into Malaysian equity market and interest in dividend (income) stocks could rise further. As foreign investors' focus will be on stocks with large market caps, dividend stocks with market caps of RM1 billion and above are more likely to see a rerating. This case study highlights a few attractive dividend (income) stocks that worth examined in 2016 (see Table 1). Their prices have appreciated strongly between 10% and 27% year to date. Despite their appreciated prices, their dividend yields remain attractive (Clint & Ho, 2016).

While foreign interest is expected to be centred largely on large-cap dividend stocks, the small-to mid-cap dividend stocks below RM1 billion market cap are also worth considering. Since the end of 2014, the FTSE Bursa Malaysia Small Cap Index increased by 3.2% or 480.96 to 15,5161.49 points on May 12, 2016. Conversely, the FTSE Bursa Malaysia KLCI index fell 6.37% or 112.27 points to 1,648.98 points during the same period. As compared to smaller-cap stocks, large-cap companies are typically possess stronger balance sheets, easier access to capital, lower cost of capital, more stable revenues and earnings, and strong cash flows to reinvest into their businesses. However, when the market moves, smaller caps will have higher leverage in terms of price movement. As such, smaller cap dividend stocks will still be new safe havens to both local and foreign institutional funds. There are some small-to mid-cap dividend stocks that are worth considering by retail investors in this case study (see Table 2) due to their strong net cash positions (Clint & Ho, 2016).

The hunt for quality dividend (income) stocks with high dividend pay-out will be the main objective and motivation of this case study, at the same time appraise whether these stocks could be highly considered by investors in their portfolio investment and diversification throughout the post 2013 general election period. Amidst the "search for yield" environment, this case study shall provide insightful information for investors to aim for the right dividend stock at the right time. Provided dividend yields are still attractive, these dividend (income) stocks would get rerated as efficient and optimal portfolio as more foreign funds will flow into them (Clint & Ho, 2016). Also, the outcomes of this case study shall assist mutual funds or unit trust funds managers who focus on stocks on different sizes, at the same time allocating their funds

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on a range of performances depending on their portfolios' mix of large-cap stocks versus small- and mid-cap stocks. Subsequently, the outputs of this case study shall motivate the authorities to impose the standard dividend policy to govern dividend payments by all Malaysian listed companies.

2. Literature review

2.1. Modern portfolio theory (MPT)

The the Modern Portfolio Theory by Harry Markowitz (MPT) (Markowitz, 1959, 1952) is a theory of investment which attempts to maximize portfolio expected return for a given amount of portfolio risk, or equivalently minimize risk for a given level of expected return, by carefully choosing the proportions of various assets (Omisore et al., 2012). Portfolio theory emphasizes the statistical relationships among the individual securities that comprise the overall portfolio (Elton & Gruber, 1997). The MPT mathematically formulates the concept of diversification in investing, with the aim of selecting a collection of investment assets that has collectively lower risk than any individual asset. In order to construct efficient and optimal portfolios, good forecasts of earnings, share prices and volatility for possibly thousands of stocks are needed. Also it is necessary to calculate its covariance with every other stock, which requires extensive calculations. This exercise needs constant repetition because of changes in the price of stocks (Mandelbrot B., 2004). The fundamental concept behind the MPT is that assets in an investment portfolio should not be selected individually, each on their own merits. Rather, it is important to consider how each asset changes in price relative to how every other asset in the portfolio changes in price. Generally, assets with higher expected returns are riskier (Taleb, 2007).

2.2. Large-caps versus small- and mid-caps

Large cap stocks tend to be industry leaders, have established track records and generally enjoy stable earnings growth. Due to their size, they are better equipped to ride out challenging economic times as compared to smaller companies. As a result of these features, the share price of large cap stocks are relatively more resilient than smaller cap stocks. In contrast, small- and mid-cap stocks tend to be new players or operate in new growth industries. Due to their smaller profit base, small- and mid-cap companies can generate higher earnings growth rates as compared to large cap companies. However, their earnings tend to be less predictable and are more vulnerable to changes in economic conditions. For this reason, small- and mid-cap stock prices are more volatile. Thus, they are considerably riskier when compared to large cap stocks (Public Mutual Berhad [PMB], 2015).

In general, large cap stocks tend to outperform during the early stages of a market upcycle, but small- and mid-cap stocks will typically outperform large caps at the later stages of a market cycle. This shift in performance is attributed to the rotational buying interest of market participants comprising institutional as well as retail investors. Sustained buying interest in large cap stocks over the course of a market's extended gain may result in the valuations of these stocks reaching the levels that are no longer deemed attractive. This may prompt market participants to subsequently search for value in small- and mid-cap stocks. As such, rotational interest into small- and mid-cap stocks generally occurs towards the mid or late part of a broad market upcycle (PMB, 2015). Several studies have been investigated on the predictability of funds returns in the developed country such as US (Sharpe, 1966; Hendricks et al., 1993; Malkiel, 1995, Carhart, 1997, Bollen & Bussen, 2005) and other developed economies (Otten & Bams, 2002 for 5 major European markets, Blake & Timmerman, 1998 for the UK, Bilson et al. 2005 for Australia). The following risk/return measures as discussed in the research methodology should rather be referred to as ex-post measures because they are defined as historical averages, rather than expectations of future performance.

3. Methodology

Table 1: Top 10 Large Cap Stocks

Company	Dividend yield (%)	Dividend Pay-out ratio (%)	Free cash flow yield (%)	Market cap (RM' million)
Berjaya Sports Toto Bhd (Trading/Services)	7.0%	80%	4%	4,098
Magnum Bhd (Trading/Services)	6.9%	101%	7%	3,301
Matrix Concept Holdings Bhd (Properties)	6.0%	39%	-4%	1,410
Carlsberg Brewery Malaysia Bhd (Consumer)	5.6%	102%	5%	3,974
Sunway Real Estate Investment Trust (REITs)	5.3%	47%	0%	4,853
IGB Real Estate Investment Trust (REITs)	5.3%	112%	6%	5,364
Pavilion Real Estate Investment Trust (REITs)	4.8%	88%	5%	5,164
Heineken Malaysia Bhd (Consumer)	4.8%	100%	7%	4,477
KLCC Stapled Group (REITs)	4.6%	115%	5%	13,721
Padini Holdings Berhad (Consumer)	4.2%	82%	9%	1,566

Source: Bloomberg (Adapted From Clint & Ho (2016, May 13))

This case study highlights ten dividend stocks with large market caps of RM1 billion and above (see Table 1), and ten small-to mid-cap dividend stocks below RM1 billion market cap which are also worth considering by retail investors (see Table 2) (adapted from Clint & Ho (2016, May 13)).

All these stocks are reported to have the highest dividend yield (%) and dividend pay-out ratio (%) up to May 12, 2016. Utilizing the periods from the year 2014 to 2016, all these stocks will be examined from the efficient, optimal portfolio investment and diversification perspective throughout the post 2013 general election period. In which a total number of 60 observations will be examined in the entire case study. The data of daily share prices and annual dividend per share over the three-year periods are all retrieved from Bloomberg. The 3-year daily stock prices and annual dividend per share are gathered in order to calculate the annualized Total Shareholder Return (TSR) for all dividend stocks.

Table 2: Top 10 Mid- and Small-Cap Stocks

Company	Dividend yield (%)	Dividend pay-out ratio (%)	Free cash flow yield (%)	Market cap (RM' million)
Formosa Prosonic Industries Bhd (Consumer)	8.8%	129%	-3%	197
SHL Consolidated Bhd (Properties)	8.4%	59%	15%	724
RCE Capital Bhd (Finance)	7.7%	424%	-51%	254
Tien Wah Press Holdings Bhd (Industrial Products)	7.7%	51%	11%	227
MRCB-QUILL REIT (REITs)	7.3%	92%	-90%	767
Classic Scenic Bhd (Consumer)	6.1%	95%	9%	159
Perusahaan Sadur	5.8%	82%	N/A	602

Timah Malaysia (PERSTIMA) Bhd (Industrial Products)				
CYL Corporation Bhd (Industrial Products)	5.6%	109%	6%	89
Fima Corporation Bhd (Industrial Products)	5.6%	54%	9%	538
Turbo-Mech Bhd (Trading/Services)	5.0%	64%	-14%	108

Source: Bloomberg (Adapted from Clint & Ho (2016, May 13))

The TSR allows the performance of stocks to be compared even though some of the stocks may have a high or low growth and high or low dividends (Smart et al., 2017). The TSR for an approximation over one year (also called as realized return or holding-period return (HPR), in this case if the holding period is 1 year) can be calculated as follows (Bodie et al., 2014):

TSR = (Cash Dividends (in this case the DPS) + Ending price of a stock – Beginning price) / Beginning price

The TSR of each stock will be analysed based on descriptive statistics: mean return (geometric mean or compound annual growth rate (CAGR) method), beta (systematic/market risk measure); standard deviation (total risk measure) and the correlation which explains the relationship among all these stocks corresponding with the FBM (FTSE Bursa Malaysia) KLCI market return. The risk-adjusted measure, namely the Sharpe ratio (1966) will be used to reaffirm the optimal portfolio performance of all dividend stocks that yields over the 3-year periods.
Sharpe Ratio:

$SP = (\bar{r}_p - \bar{r}_f) / \sigma p$

Or Reward-to-volatility ratio equates the risk premium (or excess return) divided by the standard deviation of excess return. A high portfolio's Sharpe ratio represents that a portfolio performed better on its risk-adjusted performance (Ling & Chia, 2016).
The mean results (targeted portfolio returns or risk premiums) generated from the "SOLVER" function in Excel will be used to obtain the result of Sharpe ratio. By constructing different portfolios with given target returns (0.02, 0.04, etc.), the use of "SOLVER" in excel will be utilized to find weights in which the standard deviation for the portfolio (expressed previously) is minimized. Subsequently, the efficient frontiers (as shown in Figure 1 and 2) are constructed by plotting these portfolios with return (or risk premiums) on y-axis and risk or standard deviation on x-axis. The resulting envelope curve is called the "Markowitz efficient frontier". All the portfolios on this frontier are efficient in the sense that any portfolio beneath this line will not provide a better risk-return alternative (either the portfolio will have lower return for given risk or higher risk for given return) (Markowitz, 1959, 1952). Lastly, the outcomes of "SOLVER" in excel will generate the weights for optimal portfolio in which the standard deviation for the optimal portfolio is minimized and targeted with the maximum Sharpe ratio (Omisore et al., 2012)

4. Results and discussion

The average TSR (Total Shareholder Return) as illustrated in Table 3, reported the attractiveness of portfolio investment and diversification in Padini (Consumer) and Real Estate Investment Trusts (REITs) companies, with a high TSR and optimistic forecast in 2017, in line with low beta and the lower correlation corresponding with the overall market return (FBM KLCI). The combination of these dividend stocks will generate a good option for portfolio investment and diversification. Similarly, the overall low and negative correlation as illustrated in Table 4 would raise the attractiveness of portfolio investment and diversification in mid- and small-cap companies that could emerge as hedging instrument against the negative market movement. There are several key positive attributes of small-caps firms, both structural and tactical (Mobius, 2016).

Table 3: 10 Large-Cap Companies Statistics and Forecasts on Risk Premium (Excess Return)

Company	Standard Deviation	Beta	Correlation with FBM KLCI	Average TSR	Forecast 2017
FBM KLCI	0.0142	1	1	-0.0428	-0.03
Berjaya Sports Toto	0.0541	0.5740	0.6549	-0.0311	0.01
Magnum	0.0354	0.4340	0.0197	-0.0613	-0.07
Carlsberg	0.1083	0.4316	0.8519	0.1008	0.20
Heineken	0.2255	0.2678	0.9911	0.0400	0.25
Padini	0.2898	0.6101	0.9605	0.1689	0.43
Matrix	0.1330	0.7812	-0.9521	0.1129	-0.02
Sunway REIT	0.1311	0.3306	-0.3423	0.1643	0.14
IGB REIT	0.0762	0.4356	0.3627	0.1590	0.20
Pavilion REIT	0.0674	0.3660	0.2824	0.1808	0.21
KLCC Stapled Group	0.0563	0.3796	-0.0283	0.1630	0.17

Table 4: 10 Mid- and Small-Cap Companies Statistics and Forecasts on Risk Premium (Excess Return)

Company	Standard Deviation	Beta	Correlation with FBM KLCI	Average TSR	Forecast 2017
FBM KLCI	0.0142	1	1	-0.0428	-0.03
Formosa	0.1117	0.4215	-0.1488	0.0693	0.03
SHL	0.2214	0.4892	-0.9493	0.1837	-0.01
RCE	0.1857	0.7231	0.0563	0.1078	0.15
Tien Wah	0.4566	0.2453	-0.9608	0.2926	-0.16
MRCB	0.0944	0.2287	0.3062	0.0400	0.09
Classic	0.1588	0.5078	0.5876	0.2134	0.33
PERSTIMA	0.1877	0.3846	0.7274	0.2549	0.37
CYL	0.3343	0.6213	-0.2601	0.2248	0.08
Fima	0.1345	0.4900	-0.9876	0.0411	-0.09
Turbo-Mech	0.3246	0.9571	-0.9273	0.0322	-0.29

From a structural perspective, smaller companies provide investors with exposure to many companies that having ample liquidity. Smaller companies are typically under-researched and under-owned by foreign investors, leading to market inefficiencies which potentially can be exploited. However, the types of exposures for small-cap faced are typically represent complements to the large-cap firms, particularly in areas such as the health care and consumer sectors, which fuelled by demographics and a rising middle class. As such, small caps in aggregate are able to deliver strong growth potential, as evidenced by Padini stock from large-caps, Tien Wah and Classic Scenic from mid- and small-caps. These companies are typically more locally focused and many are relatively dominant players in smaller industries. The most successful smaller companies will leverage such local strength to expand

internationally, supporting their transition into mid- or even large-cap companies over time. Tactically, smaller companies are generally have greater local market exposure and as a result, have historically had reduced correlation (the degree they move in tandem) with their larger-cap counterparts (Mobius, 2016).

In the case of no short sales activities, in line with the aim to construct optimal portfolio with the highest Sharpe ratio (i.e., reward-to-volatility ratio), the weights of optimal portfolio (for all large-cap companies) as shown in Table 5 are able to generate the slope or the Sharpe ratio of 72.55, resulting in a higher excess return of 9.94% at the minimal total risk exposure at only 0.14%. As recommended by the optimal portfolio in Table 5, about 60% of the total investment funds should be allocated in Matrix (Properties sector – 32%), IGB REIT (20%) and Pavilion REIT (10%), another 10% funds should be allocated in Padini (Consumer).

With the mean return of 9.94% for ten large-cap companies in optimal portfolio from Table 5, the Sharpe ratio will yield 101.57 (ignoring the risk-free investment). Similarly, with the mean return of 21.31% for all ten mid- and small-cap companies in optimal portfolio from Table 6, in line with the very minimal total risk exposure (0.000025), the Sharpe ratio for mid- and small-cap stocks will yield abnormally large at 8,389.76 (ignoring the risk-free investment). This implies that the higher perceived risks and uncertainties of investing mid- and small-cap stocks should yield higher excess return in order to compensate the high risks investing in these stocks.

The outcomes of optimal portfolio in Table 6 suggests that 20% of the total investment funds should be allocated in SHL consolidated Bhd (Properties) and MRCB-QUILL REIT, and about 40% of the portfolio investment funds should be targeted on the sector of industrial products (PERSTIMA – 36% and Tien Wah – 7%), in which both companies are indirectly linked with the consumer sentiment. As evidenced by both PERSTIMA and Tien Wah in this case study, the growth of small-cap companies are typically organic and derived from local market dynamics. In addition to organic growth, smaller companies may also see share-price appreciation from being added to an index (thus attracting passive investor flows, and with increased sell-side research attention likely attracting active fund flows as well) as well as being potential merger-and-acquisition targets – these are growth drivers that are, to a great extent, independent of macroeconomic considerations (Mobius, 2016).

5. Conclusion

The overall outcomes of this case study tend to provide insightful information in answering some pertinent questions come to most investors' mind, particularly for income investors: Can the companies maintain dividends amid a slowing economy? And most importantly, are there any sectors or companies that are paying better dividends? The REITs which examined in this case study are able to provide higher cash dividend pay-outs than others, as supported by the empirical analysis results in Table 5 and key statistics in Table 1.

Table 5: The Weights for Both Minimum Variance and Optimal Portfolio (from the SOLVER in Excel) – 10 Large-Cap Companies

	Minimum Variance Portfolio	Optimal Portfolio
Mean	-0.0159	0.0994
SD	0.0000	0.0014
Slope (Sharpe)	-20556.4516	72.5589
FBM KLCI	0.8236	0.1537
Berjaya Sports Toto	0.0000	0.0002
Magnum	0.0199	0.0676
Carlsberg	0.0020	0.0258
Heineken	0.0000	0.0038
Padini	0.0068	0.0998
Matrix	0.0967	0.3236
Sunway REIT	0.0330	0.0014
IGB REIT	0.0000	0.2065
Pavilion REIT	0.0000	0.1050
KLCC Stapled Group	0.0179	0.0127
CAL*	0.0001	0.0994

Table 6: The Weights for Both Minimum Variance and Optimal Portfolio (from the SOLVER in Excel) – 10 Mid- and Small-Cap Companies

	Minimum Variance Portfolio	Optimal Portfolio
Mean	-0.0299	0.2131
SD	0.0000	0.0000
Slope (Sharpe)	-17253.3853	8382.9752
FBM KLCI	0.9368	0.0028
Formosa	0.0000	0.0023
SHL	0.0119	0.1912
RCE	0.0063	0.0294
Tien Wah	0.0180	0.0651
MRCB	0.0042	0.0322
Classic	0.0058	0.2880
PERSTIMA	0.0001	0.3599
CYL	0.0000	0.0013
Fima	0.0087	0.0000
Turbo-Mech	0.0082	0.0277
CAL*	0.0146	0.2131

Notes: *Risk Premium on CAL (Capital Allocation Line) Equates SD × Slope of Optimal Risky Portfolio

In line with various researchers who claimed that Malaysian REITs are able to provide diversification benefits through REITs inclusion in the portfolio (Lee & Ting, 2009; Abdul Jalil et al., 2008), REITs have the ability to provide reliable income derived from tenant on a longer lease period. Besides, the tax rule which required REITs to distribute at least 90 percent of REITs' taxable income to shareholders annually in the form of divided. This had resulted REITs paid dividend yield higher than average companies throughout all market condition (Chan et al., 2003; Zietz et al., 2003). Simply put, the REITs market will also be heavily influenced by the approach to tax and tax efficiency (LaBrooy, 2015). Due to these characteristics, REITs raised as a hybrid investment offering liquidity as stock and the income stream, secured by a long lease in quality commercial real estate (Newell, 2002). The 2016 market rally on Malaysian REIT counters are mainly attributable to Bank Negara's move to cut the overnight policy rate (OPR) by 25 basis points to 3% on July 13, 2016, which lowered the Malaysian Government Securities (MGS) yield. The wider difference between MGS and Malaysian REITs makes the latter an attractive investment. While the cutting of OPR has benefited Malaysian REITs as a whole, the biggest beneficiary of the change in monetary policy would be the retail-based REITs, which are optimistic on the tenant sales growth recorded at major malls (Ho, 2016).

Whilst companies could liquidate assets or use borrowings to pay dividends, the ability to sustain and grow dividends is still driven by profitability and free cash flow yield. Many of the dividend growers as identified in this case study have unique competitive strengths to capture the growth of their respective industry. The overall observation signify the sheer size of the small cap firms' investments provide abundant opportunities to uncover mispriced companies (Mobius, 2016).

With respect to the policy implication, Bursa Malaysia thus far doesn't have rules to compel listed companies to pay decent cash dividends based on net profits. Some authorities suggests that the Securities Commission could consider mandating listed companies to pay, say at least 40% of their net profits as dividends. They can also be compelled to ensure that their retained earnings are not more than 50% of their paid-up capital. Such rules will make the listed companies more attractive to investors. And by paying good dividends, minority shareholders can decide what to do with their excess cash. However, the minorities would lose out if listed companies were fined for not paying dividends because their cash reserves would be reduced. In other words, the listed companies would be punished at the expense of minority shareholders (Liew, 2017). Acknowledge that there are legitimate reasons for withholding the dividend payments, such as when cash reserves are required for future business expansion or to make provisions for

contingencies due to adverse economic cycles. Hence, the legislative issues on mandating dividend policy in Malaysia will still be an on-going debate thus far and possible for future research.

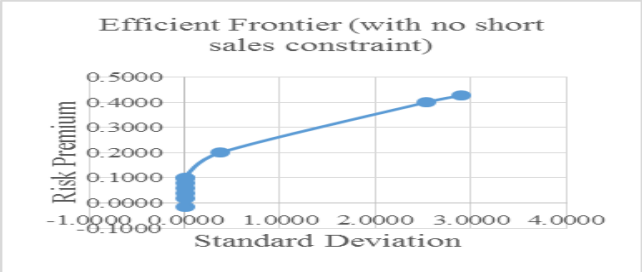

Fig. 1: The Efficient Frontier for 10 Large-Cap Companies with No Short Sales Constraint.

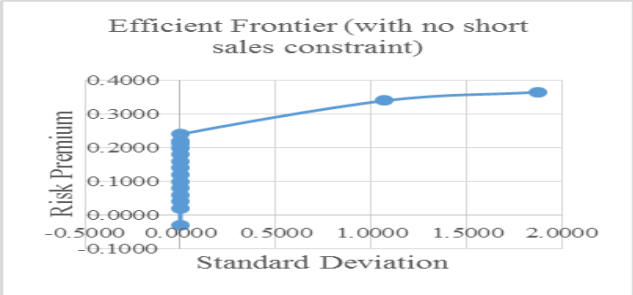

Fig. 2: The Efficient Frontier for 10 Mid- and Small-Cap Companies with No Short Sales Constraint.

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