Briefly Noted

The Effect of Dividend Changes on Expected Cash Flows

Dividend announcements and changes are perceived as signaling information about a company's financial prospects. Positive revisions are often viewed as conveying optimism on the part of management about future earnings and cash flows, while negative revisions are perceived as conveying pessimism. A University of Chicago working paper challenges this viewpoint. The study's authors find evidence of a link between dividend announcements and future changes in cash flow volatility.

Dividend increases are followed, in aggregate, by a reduced variance in cash flows (referred to as "cash-flow news") over the next five years. Put another a way, there is 15% less volatility in future cash flows following an announcement of a higher dividend relative to what there was during the five-year period preceding the announcement.

The opposite occurs with dividend decreases—the variability of expected cash flows increases. Specifically, there is 7% greater volatility in cash-flow news following a cut to the dividend. Omitting the dividend altogether leads to a similar increase in cash-flow news variance.

The different reactions imply that a correlation exists between dividend changes and a subsequent change in the variance of cash-flow news in the opposite direction. The study's authors interpret their finding as implying that companies "change their dividend payout in anticipation of future changes in cash-flow volatility."

Larger dividend hikes have a greater impact. The variance in post-increase cash-flow news drops by more than 19% on average for larger-than-median hikes. Smaller-than-median dividend increases tend to be followed by 8% smaller decreases in variance.

There is also a link between the type of dividend change and the announcement return. (The announcement return is the cumulative returns during a three-day window bracketing the dividend announcement event.) Announcement returns are "significantly larger" (meaning more positive) for above-median dividend increases than they are for below-median increases. When dividends are cut, announcement returns are "significantly" more negative for larger-than-median decreases than they are for smaller-than-median decreases.

"The Information Content of Dividends: Safer Profits, Not Higher Profits;" Roni Michaely, Stefano Rossi and Michael Weber; Becker Friedman Institute for Research in Economics; Working Paper Series No. 2017-19; November 2017.

Useful End-of-Life Documents

A will is a well-known and important tool in estate planning. There are other documents you should consider having to better ensure that your late-in-life and end-of-life wishes are carried out. At the 2017 Schwab IMPACT Conference, grief studies expert Amy Florian suggested these documents, among others.

Living Will: States what medical treatments you do and do not want. Florian recommends Five Wishes From Aging With Dignity (www.agingwithdignity.org). This document not only covers medical treatment options but also your desires regarding remembrances and memorial services. The document is valid in 42 states and the District of Columbia.

POLST: These "physician orders for life-sustaining treatment" state your goals for care when diagnosed with a serious illness or incurring frailty toward the end of life. When given to a doctor, they become part of your medical record. The National POLST Paradigm provides such a form (www.polst.org).

Health Care Proxy: Designating a person to make health care decisions on your behalf is important should you become incapacitated. This can be accomplished by assigning someone medical power of attorney. Establish a hierarchy if you want to designate more than one person and have conversations with those you entrust about your wishes and desires.

DNR/DNI Orders: Although the POLST may already include orders not to resuscitate or intubate, Florian believes it is important to have redundancy in the form of documentation. Make sure the orders are visible in the hospital room since the procedures can otherwise be done without permission.

Personal Property Memorandum: Specifically stating which heir will inherit which personal possession can help to avoid disputes after you pass. Florian says 30 states recognize a separate personal property memorandum when the document is mentioned in a will.

Digital Assets Memorandum: This newer type of document lists instructions for how your digital assets will be handled, including who will receive ownership of them. Include all of your digital assets, such as email, social media accounts, photos and digital file backups.

Source: "Got a Will? Here Are 11 More End-of-Life Documents You May Need;" Kelli Grant, CNBC.com, November 15, 2017.

Delaying SEC Filings Leads to Negative Returns

Exchange-listed companies are generally required by the Securities and Exchange Commission (SEC) to file annual reports (Form 10-K) within 75 days (60 days for large companies) following the end of a calendar or fiscal year. The deadlines for the quarterly 10-Q are generally 40 days for most companies. (Companies with a float—meaning the dollar value of shares available for public trading—of $75 million or less have 90 days and 45 days, respectively, to file.)

Failure to meet these deadlines triggers a requirement to file SEC Form NT and can lead to a declining stock price. A forthcoming study found that the average decline for the five days surrounding the filing deadline for late filers is 2.44%. By type of filing, the drop is 2.93% for late 10-Q filers and 1.96% for late 10-K filers. The returns were measured for companies filing Form NT during the period of 2000 through 2008.

Form NT gives companies a list of reasons to explain why their reports will be delayed. When accounting problems are checked, investors react more negatively to late 10-Q filings. The researchers surmise that this may potentially be due to the lack of audited numbers used in the quarterly reports. As such, investors could be interpreting the reasons for the delay in filing being "significantly more serious than the accounting problems signaled by management's inability to file a timely annual report."

Notably, the data also suggests that investors correctly anticipate which companies will fail to file their 10-Q or 10-K within the SEC's grace periods (five and 15 days, respectively). Shares of these 664 companies decline by 3.51% during the aforementioned five-day window versus a decline of 1.72% for the 1,169 companies meeting the grace period requirements. "Investors do not blithely react to management's declaration," conclude the study's authors.

Stock prices for late filers continue to decline for several months after the NT filing date. The additional drop is 13%, on average, over the following 180 trading days. While accounting problems have a more negative effect initially, post-NT-filing declines are bigger for companies describing the reasons for the delay as uncertain, due to corporate events or due to multiple reasons.

Source: "SEC Filings, Regulatory Deadlines, and Capital Market Consequences;" Eli Bartov and Yaniv Konchitchki; forthcoming, Accounting Horizons.

Corporations Do Not Optimize Share Repurchases

Despite possessing insider information, corporate executives would realize higher returns on share repurchase programs if they simply follow a dollar-cost-averaging approach, according to a recent study. Buying shares in equal dollar amounts over a period of time was found to be better than the discretionary purchase strategy used by corporations.

The study's authors looked at nearly 5,500 U.S. corporations with at least one recorded event of share repurchases between 1984 and 2010. A firm was included if it bought back the equivalent of at least 0.1% of its outstanding shares during a quarter.

On average, companies realized a return of 7.66% during the one-year period following their share repurchases based on end-of-quarter prices. Though positive, it was less than what they would have realized by following systematic dollar cost averaging. Annualized returns for the "smoothed" approach were between 0.5% to 2.0% depending on the length of time over which purchases occurred (ranging from one year to the firm's lifetime).

Actual data on share repurchases became available after 2004. When returns were calculated based on actual reported prices and amounts, discretionary purchases realized a higher one-year return than the systematic approach would have. This advantage was not lasting, with the dollar-cost-averaging strategy realizing higher annualized returns over periods of two years and longer. This disparity existed even when executives explicitly gave perceived undervaluation as the reason for buying back shares. As the study's authors explain, "Even the group of firms that publicly assert that they are making a good investment in their stock could have made a better investment by just mechanically spreading out their repurchases evenly."

Corporations do buy back stock for reasons other than valuation. One reason is to help meet earnings expectations or to offset potential share dilution (not uncommon sources of criticism). Doing so incurs costs relative to dollar cost averaging.

A few other observations of note from the study: The median repurchase amount for companies making repurchases is $5.08 million per quarter; the median proportionate amount of outstanding shares purchased each quarter for these companies is 0.84%.

Source: "The Cost of Financial Flexibility: Evidence From Share Repurchases;" Alice Bonaimé, Kristine Hankins and Bradford Jordan; Journal of Corporate Finance; February 11, 2016.