

Income Opportunities: Finding Income in an Inflationary Environment

November 4, 2021

With the Fed announcing its intent to taper asset purchases and the market expecting possible interest rate hikes as soon as 2022, many investors have been looking for a way to find more income in an inflationary environment. Several indicators have been signaling rising prices, and the Fed expects inflationary pressures to remain elevated into next year. For example, the Social Security Cost-of-Living adjustment for 2022 was 5.9% y/y—the highest annual increase since 1982.¹ And headline numbers for the Consumer Price Index (CPI) increased 5.4% y/y in September (averaging over 4% annually).²

Recent inflationary pressures have been attributed to several lingering effects of the COVID-19 pandemic. Consumers shifted to buying goods over services, and demand for certain goods like home appliances and electronics increased significantly. Inventories were stretched thin, and supply chains were stressed as they were expected to move more goods on irregular routes. As a result, input costs rose including transportation costs and materials (e.g., copper, steel, semiconductors). Additionally, as many workers took unemployment and stimulus payments, companies scrambled to find workers as the economy re-opened, often having to resort to higher wages as incentive. As costs for corporations increased, companies with strong pricing power have increased prices of goods and services. These include sectors like healthcare and consumer staples, which have relatively stable demand in all economic conditions.

Why are investors concerned about inflation?

Inflation decreases purchasing power. Put simply—when the price of goods and services increases and your income does not increase (or increases at a slower rate), then you need more money to purchase the same goods. For an investor, this means that if inflation is 4% during the year and the investment portfolio also had a 4% total return, then the real return (i.e., inflation-adjusted return) is 0%. Theoretically, the investor could have held onto that money instead of spending time and effort investing.

Inflation can also diminish equity performance. The Fed can increase short-term interest rates in response to inflation. Equities generally react negatively to higher interest rates since the cost of borrowing becomes more expensive, which could reduce capital spending and hurt earnings growth. Additionally, higher interest rates can reduce valuations of future cash flows.

How do dividend investments perform during periods of high inflation?

While dividends are not a perfect inflation hedge, dividend payments are generally less volatile than earnings for several reasons. As mentioned earlier, those companies with strong pricing power can more effectively pass cost increases to customers and can maintain or even grow dividends during periods of high inflation. Even those companies that experience short-term earnings weakness due to inflation may still maintain their dividend payments to shareholders. Generally, dividend cuts are relatively uncommon since they send a negative signal about a company's financial position and are often followed by price deterioration. When using an indexed product, the effect of one or even a few dividend cuts is reduced when averaged along with other constituents.

1. The United States Social Security Administration – [2022 Cost-of-Living adjustment](#)
2. Bureau of Labor Statistics – [September 2022 Consumer Price Index Summary](#)

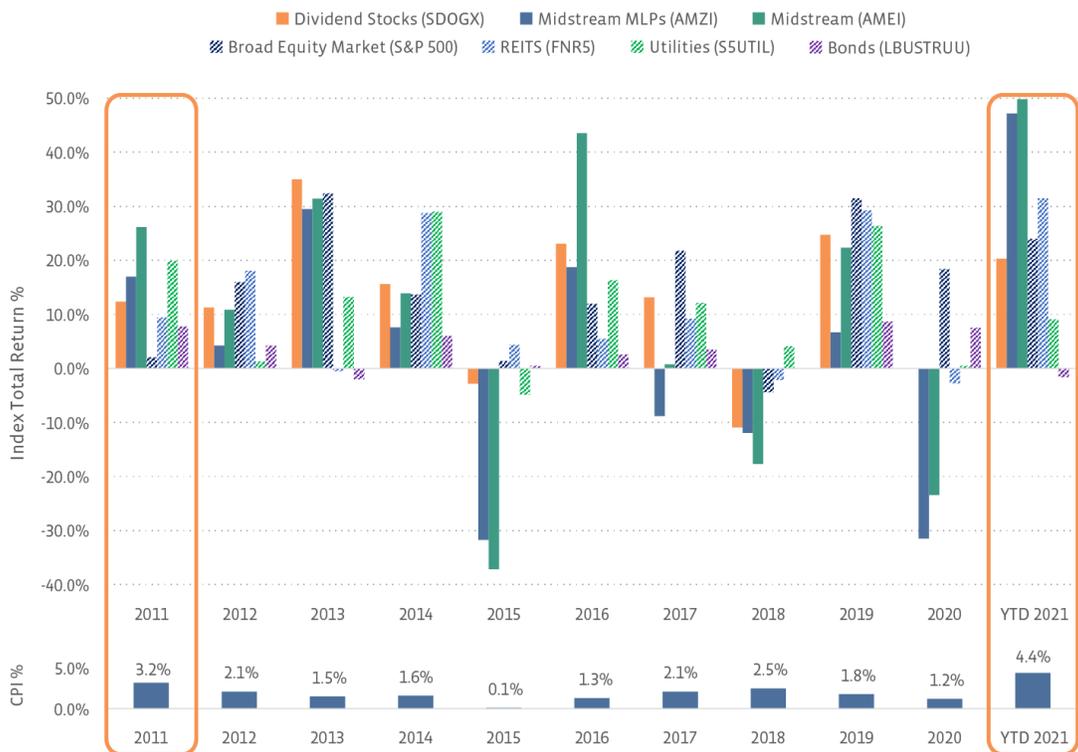
Other equity investments may also have additional inflation protection built into their dividends. Midstream companies, for example, often have contract provisions that protect them from inflation and offer the ability to pass on higher costs to customers.³ REITs also have inflation protection built into their dividend payments since real estate rental prices are typically tied to inflation—particularly for apartment leases which can typically be adjusted annually and for hotel REITs which can adjust room rates almost daily.

In contrast to equity dividends, bond coupons are usually paid at a fixed rate—so if inflation increases, the coupon payment stays low. This also decreases the selling price of the bond as new bonds are issued with higher coupons and older bonds become less valuable.

Bottom line:

Equities which pay dividends are typically better positioned in an inflationary environment compared to the broader equity market or fixed income investments. While negative sentiment related to rising inflation or interest rates can hurt stock prices and temporarily weaken margins (and the price return of an investment), the relative stability of dividend income can help drive a higher total return. The total return for income-oriented indexes has often outperformed the broader market during high inflation years (e.g., 2011 and YTD 2021).

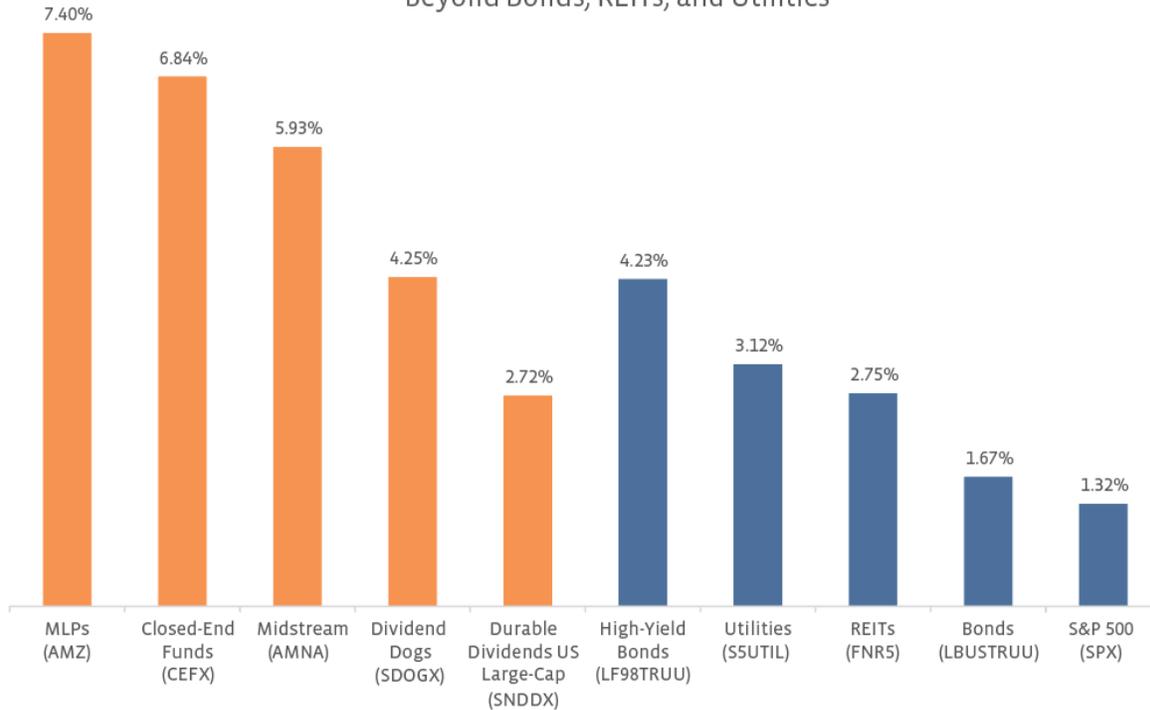
Alerian/S-Network Income Indexes Generally Outperform During High Inflation Years



Source: Bureau of Labor Statistics, Bloomberg, Alerian & S-Network Global Indexes as of 10/29/2021
 Inflation value represents the consensus inflation forecast for 2021 according to Bloomberg's latest survey conducted October 8-14

AMZI is the underlying index for the Alerian MLP ETF (AMLP) and the ETRACS Alerian MLP Infrastructure Index ETN Series B (MLPB). AMEI is the underlying index for the Alerian Energy Infrastructure ETF (ENFR). SDOGX is the underlying index for the ALPS Sector Dividend Dogs ETF (SDOG).

Alerian/S-Network Indexes Showcase Attractive Income Opportunities Beyond Bonds, REITs, and Utilities



AMZ and AMNA yields are calculated by Alerian. All other yields are Bloomberg data. Source: Alerian and S-Network Global Indexes, Bloomberg as of October 29, 2021

Current Yields vs. History

Following significant price improvement year-to-date through October, midstream yields are generally below 5-year historical averages, but YTD total returns are close to 50%.

Midstream & MLPs

Index Name	Ticker	YTD Total Return	Yield		
			Current	5-Year Average	10-Year Average
Alerian Midstream Energy Index	AMNA	47.40%	5.93%	6.59%	N/A
Alerian MLP Index	AMZ	46.34%	7.40%	8.80%	7.65%
Alerian MLP Infrastructure Index	AMZI	47.17%	7.40%	8.76%	7.55%
Alerian Midstream Energy Dividend Index	AEDW	45.09%	6.85%	7.63%	N/A
Alerian Midstream Energy Select Index	AMEI	49.77%	5.87%	6.39%	5.41%

Source: Alerian & S-Network Global Indexes as of October 29, 2021

Of the S-Network Sector Dividend Dogs, SDOGX and RDOGX have YTD total return over 20%. SDOGX has a current yield only modestly below its 5-year average.

Sector Dividend Dogs

Index Name	Ticker	YTD Total Return	Yield	
			Current	5-Year Average
S-Network Sector Dividend Dogs Index	SDOGX	20.33%	4.25%	4.45%
S-Network International Sector Dividend Dogs Index	IDOGX	10.44%	5.14%	5.18%
S-Network Emerging Sector Dividend Dogs Index	EDOGX	12.44%	5.46%	5.03%
S-Network REIT Dividend Dogs Index	RDOGX	27.25%	4.35%	N/A

Source: Alerian & S-Network Global Indexes as of October 29, 2021

Multiple screens for dividend durability, including evaluating cash flows, EBITDA, and debt-to-equity ratios, help ensure reliable income from the durable dividend indexes. While current yields are below the 5-year average, they are well above the S&P 500's current 1.32% yield.

Durable Dividends

Index Name	Ticker	YTD Total Return	Yield	
			Current	5-Year Average
S-Network Durable Dividends US Large-Cap Index	SNDDX	23.52%	2.72%	3.57%
S-Network Durable Dividends US Mid-Cap Index	SNDDMX	22.68%	2.15%	3.18%
S-Network Durable Dividends Developed International Index	SNDDIX	17.00%	4.27%	4.60%

Source: Alerian & S-Network Global Indexes as of October 29, 2021

Though current yields are below historical averages, closed-end funds continue to represent an attractive option for enhancing the yield of an income-oriented portfolio.

Closed-End Funds

Index Name	Ticker	YTD Total Return	Yield			
			Current	Tax-Equivalent ¹	5-Year Average	10-Year Average
S-Network Composite Closed-End Fund Index	CEFX	15.73%	6.84%	N/A	8.00%	8.34%
S-Network Municipal Bond Closed-End Fund Index	CEFMX	5.40%	4.49%	7.13%	4.95%	N/A
S-Network Option Income Closed-End Fund Index	CEFOIX	12.80%	7.03%	N/A	8.20%	N/A

¹ Calculated using a 37% federal tax rate.

Source: Alerian & S-Network Global Indexes as of October 29, 2021

Related Research:

[Robust Free Cash Flow Generation Sets Midstream Apart](#)

[Midstream Partnering for a Cleaner Tomorrow](#)

[US Production Outlook: Modest Growth Could Be Just Right](#)

[A Lesson on Leverage in Municipal Bond Closed-End Funds](#)

[Income Opportunities: High Yields Don't Have to Mean Low Quality](#)

Underlying Index

Midstream/MLPs

[Alerian Midstream Energy Index \(AMNA\)](#)

[Alerian MLP Index \(AMZ\)](#)

[Alerian Midstream Energy Dividend Index \(AEDW\)](#)

[Alerian MLP Infrastructure Index \(AMZI\)](#)

[Alerian Midstream Energy Select Index \(AMEI\)](#)

Sector Dividend Dogs

[S-Network Sector Dividend Dogs Index \(SDOGX\)](#)

[S-Network International Sector Dividend Dogs Index \(IDOGX\)](#)

[S-Network Emerging Sector Dividend Dogs Index \(EDOGX\)](#)

[S-Network REIT Dividend Dogs Index \(RDOGX\)](#)

Closed-End Funds

[S-Network Composite Closed-End Fund Index \(CEFX\)](#)

[S-Network Municipal Bond Closed-End Fund Index \(CEFMX\)](#)

Associated Product

ETRACS Alerian Midstream Energy Index ETN (AMNA)

JP Morgan Alerian MLP Index ETN (AMJ), ETRACS Alerian MLP Index ETN Series B (AMUB), ETRACS Quarterly Pay 1.5X Levered Alerian MLP Index ETN (MLPR)

ETRACS Alerian Midstream Energy High Dividend Index ETN (AMND), Alerian Midstream Energy Dividend UCITS ETF (MMLP)

Alerian MLP ETF (AMLPL), ETRACS Alerian MLP Infrastructure Index ETN Series B (MLPB)

Alerian Energy Infrastructure ETF (ENFR)

ALPS Sector Dividend Dogs ETF (SDOG)

ALPS International Sector Dividend Dogs ETF (IDOG)

ALPS Emerging Sector Dividend Dogs ETF (EDOG)

ALPS REIT Dividend Dogs ETF (RDOG)

Invesco CEF Income Composite ETF (PCEF), ETRACS 1.5X Leveraged Closed-End Fund ETN (CEFD)

VanEck Vectors CEF Municipal Income ETF (XMPT)

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