The Hartford Mutual Funds
WHITEPAPER

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THE HARTFORD

THE POWER OF DIVIDENDS

Past, Present, and Future

Avoiding fads can be an important part of investment success. When everyone is talking about an investment, it's often a sell signal since the masses generally buy investments *after* they've significantly increased in value.

With this in mind, we need to wonder if all the talk about dividend-paying stocks is just a fad, or if there's real merit to the dividend argument, particularly at this point in market history. In this white paper we'll take a historical look at dividends and examine the future for dividend investors.

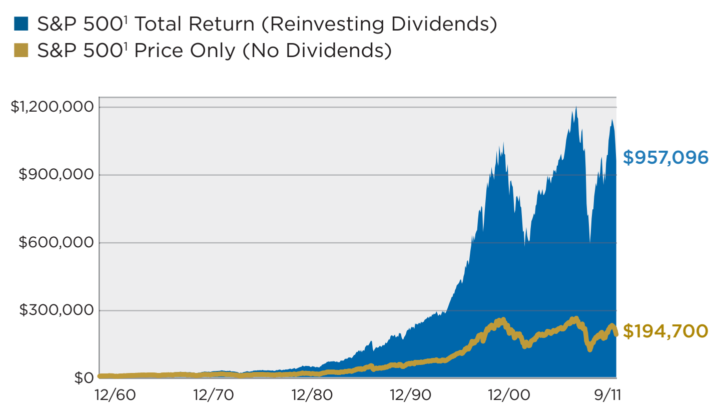
INSIDE

The Long-Term View

Dividends have played a significant role in the returns investors have received over the past 50 years. Going back to 1960, 79.5% of the total return of the S&P 500 Index[1] can be attributed to reinvested dividends and the power of compounding, as illustrated in Figure 1.

FIGURE 1

The Power of Dividends and Compounding:
Growth of $10,000 (12/1960–9/2011)



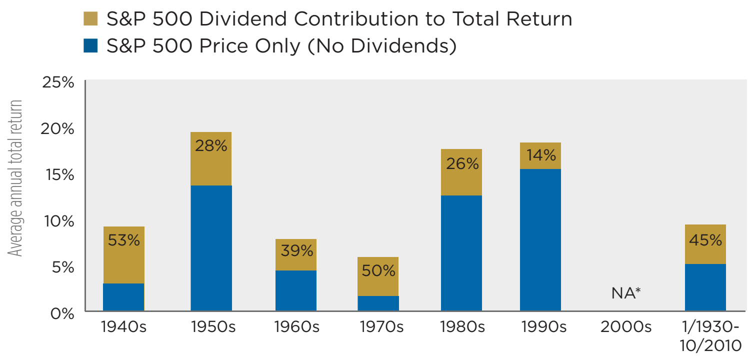
Data Source: Morningstar 10/11.

PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE RESULTS. The graph shown is for illustrative purposes only. Dividend-paying stocks are not guaranteed to outperform non-dividend-paying stocks in a declining, flat, or rising market. The graph does not represent the performance of The Hartford Mutual Funds, and does not take into account fees and charges associated with actual investments.

Decade By Decade: How Dividends Impacted Returns

Looking at average stock performance over a longer timeframe provides a more granular perspective. Over the past eight decades, dividend income's contribution to the total return of the S&P 500 Index[1] averaged 45%. Looking at S&P 500 performance on a decade-by-decade basis shows how dividends' contribution varied greatly from decade to decade.

FIGURE 2 Dividends' Contribution to Total Return Decade By Decade



Data Sources: Standard & Poor's, Morningstar, Wellington Management estimates based on a monthly calculation 10/11.
*Total return for the S&P 500 was negative for the 2000s. Dividends provided a 1.8% annualized return over the decade.

Dividends played a large role in terms of their contribution to total returns during the 1940s, 1960s, and 1970s, decades when total returns were lower than 10%. In contrast, dividends played a smaller role during the 1950s, 1980s, and 1990s when average annual total returns for the decade were well into double digits.

During the 1990s, dividends were de-emphasized. Companies' thinking at the time was that they were better able to deploy their capital by reinvesting it in their businesses rather than returning it to shareholders. Significant capital appreciation year in and year out caused investors to shift their attention away from dividends.

From 2000 to 2009, a period often referred to as the "lost decade," the S&P 500[1] produced a negative return. Largely as a result of the bursting of the dot-com bubble in March 2000, stock investors once again turned to fundamentals such as P/E ratios and dividend yields.

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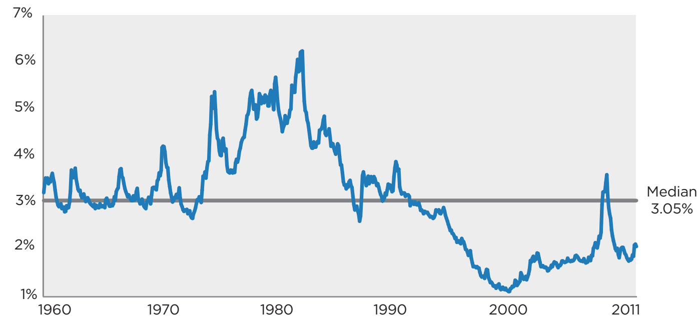
Figure 3 summarizes the dividend yield for the S&P 500 Index[1] over the past 50 years. The median dividend yield for the entire period was 3.05%, with yields peaking in the 1980s and bottoming in the 2000s. After a decade with no capital appreciation, investors are placing a higher premium on the more tangible and immediate returns that dividends provide.

FIGURE 3 S&P 500[1] Dividend Yield: 1/1/1960-12/14/2011



Data Source: Morningstar, 10/11.

When "Second Best" Is Best

Investors seeking dividend-paying investments may make the mistake of simply choosing those that offer the highest yields possible. A recent study conducted by our sub-advisor Wellington Management reveals the potential flaws in this thinking.

The study found that stocks offering the highest level of dividend payouts have not performed as well as those that pay high, but not the very highest, levels of dividends.

This conclusion is counterintuitive: Why wouldn't the highest-yielding stocks have the best historical total returns? Isn't the ability to pay a generous dividend a sign of a healthy underlying business?

We'll answer these questions in a moment, but we'll begin by summarizing the methodology and findings of the study.

Wellington Management began by dividing dividend-paying stocks into quintiles by their level of dividend payouts. The first quintile (i.e. top 20%) consisted of the highest dividend payers, while the fifth quintile (i.e. bottom 20%) consisted of the lowest dividend payers.

Figure 4 summarizes the performance of the S&P 500 Index[1] as a whole relative to each quintile over the past eight decades.

FIGURE 4 Percentage of Time Dividend Payers by Quintile Outperformed the S&P 500[1] From 1929-2009 (Summary of Data in Figure 5)

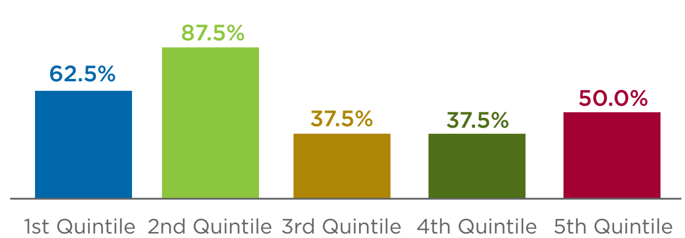


FIGURE 5

Compound Annual Growth Rate (%) for U.S. Stocks by Dividend Yield Quintile by Decade, 1929 – 2009

	S&P 500[1]	1st Quintile	2nd Quintile	3rd Quintile	4th Quintile	5th Quintile
December 1929 – 1939	**-0.5%**	-1.0%	**0.8%**	-1.3%	-1.0%	2.3%
December 1939 – 1949	**9.0%**	14.0%	**13.3%**	10.4%	8.7%	7.0%
December 1949 – 1959	**19.3%**	18.5%	**20.2%**	18.3%	16.4%	19.8%
December 1959 – 1969	**7.8%**	8.7%	**8.9%**	6.6%	8.0%	9.3%
December 1969 – 1979	**5.9%**	9.7%	**10.2%**	7.0%	7.8%	3.8%
December 1979 – 1989	**17.6%**	20.2%	**19.6%**	17.1%	16.2%	14.7%
December 1989 – 1999	**18.2%**	12.4%	**15.6%**	15.1%	18.1%	18.9%
December 1999 – 2009	**-0.9%**	5.5%	**4.2%**	4.3%	1.9%	-1.7%

Data Sources: Professor Kenneth French, Dartmouth College (Data compiled by RBC Capital) and Wellington Management, 10/11. U.S. stocks are represented by the S&P 500 Index, which is a composite of the 500 largest companies in the U.S. The Index is unmanaged and not available for direct investment.

The second-quintile stocks outperformed the S&P 500 Index[1] seven out of the eight decades (1929 to 2009), or 87.5% of the time, while first-quintile stocks came in a distant second, beating the Index just 62.5% of the time. Third, fourth-, and fifth-quintile stocks lagged behind the first and second-quintile dividend payers.

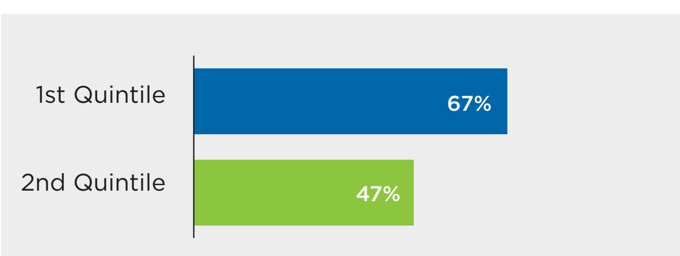
Payout Ratio: A Critical Metric

One reason why second-quintile dividend stocks came out ahead is because the first-quintile's excessive dividend payouts haven't always been sustainable. The best way to measure whether a company will be able to pay a consistent dividend is through the payout ratio.

The payout ratio is calculated by dividing the yearly dividend per share by the earnings per share. A high payout ratio means that a company is using a significant percentage of its earnings to pay a dividend, which leaves them with less money to invest in future growth of the business.

The chart below illustrates the average dividend payout ratio for a 30-year period for the first two quintiles of dividend payers within the Russell 1000 Index.[3] The first-quintile stocks had an average dividend payout ratio of 67%, while the second quintile had a 47% average payout ratio.

FIGURE 6 **Average Dividend Payout Ratio** (1979–2009)



Data Source: Wellington Management, 10/11. Payout ratios illustrated are for stocks within the Russell 1000 Index. This Index represents the highest-ranking 1,000 stocks in the Russell 3000 Index, which represents about 90% of the total market capitalization of that Index. The Russell 1000 Index has a weighted-average market capitalization of $81 billion; the median market capitalization is approximately $4.6 billion, and the smallest company in the Index has a market capitalization of $1.8 billion.

A payout ratio of 67% could be difficult to sustain if a company experiences a drop in earnings. Once this happens, a company could be forced to cut its dividend. A dividend cut is often viewed as a sign of weakness in the financial markets and frequently results in a decline in the price of the company's stock.

Do Dividend Policies Affect Stock Performance?

In an effort to learn more about the relative performance of companies according to their dividend policies, Ned Davis Research conducted a study in which they divided companies into two groups based upon whether or not they paid a dividend during the previous 12 months. They named these two groups "divided payers" and "dividend non-payers."

The "dividend payers" were then divided into three groups based on their dividend payout behavior during the previous 12 months. Companies that kept their dividends per share at the same level were classified as "no change." Companies that raised their dividends were classified as "dividend growers and initiators." Companies that lowered or eliminated their dividends were classified as "dividend cutters or eliminators." Companies that were classified as either "dividend growers and initiators" or "dividend cutters and eliminators" remained in these same categories for the next 12 months, or until there was another dividend change.

For each of the five categories (dividend payers, dividend non-payers, dividend growers and initiators, dividend non-payers, and no change in dividend policy) a total return geometric average was calculated; monthly rebalancing was also employed.

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Based on the Ned Davis study, it's clear that companies that cut their dividends suffered negative consequences. In Figure 7, dividend cutters and eliminators (e.g. companies that completely eliminated their dividends) were more volatile (as measured by beta and standard deviation) and fared worse than companies that never paid a dividend at all (dividend non-payers).

FIGURE 7 **Average Annual Returns and Volatility by Dividend Policy: 1/1/72-9/30/11**

	Returns	Beta[4]	Standard Deviation[5]
Dividend Growers & Initiators	9.10%	0.87	16.31%
Dividend Payers	8.31%	0.93	17.11%
No Change in Dividend Policy	6.77%	0.99	18.43%
Dividend Non-Payers	1.17%	1.30	25.73%
Dividend Cutters & Eliminators	-1.22%	1.22	25.72%
Equal-Weighted S&P 500 Index[1]	6.76%	1.00	18.09%

Data Source: Ned Davis Research, 10/11. Stocks within the S&P 500 Index.

Lowest Risk *and* Highest Returns for Dividend Growers & Initiators

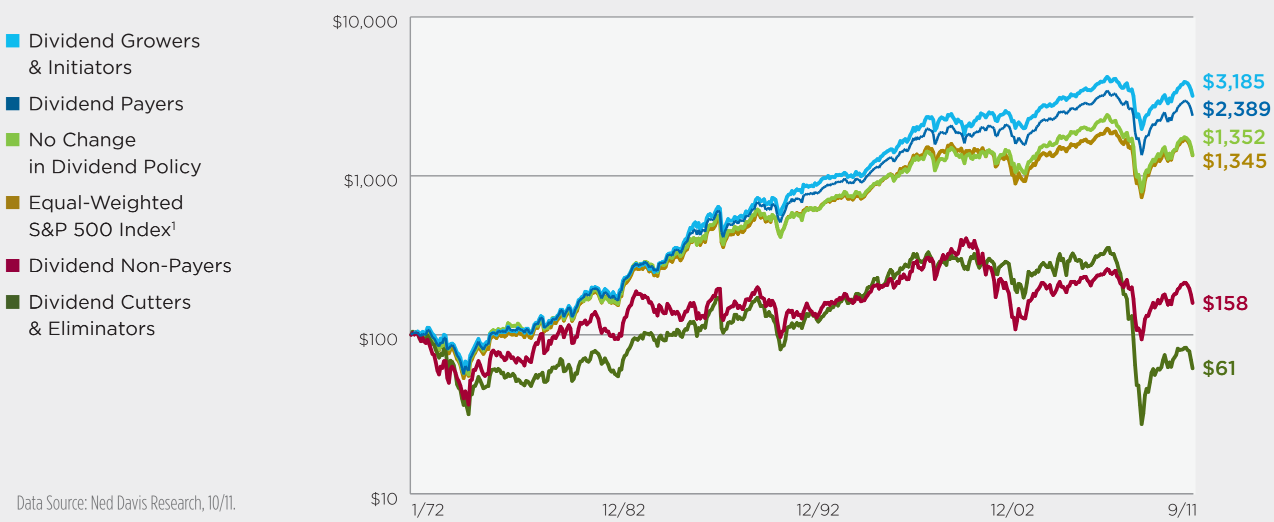
In contrast to companies that cut or eliminated their dividends, companies that grew or initiated a dividend have experienced the highest returns relative to other stocks since 1972—with significantly less volatility. This helps explain why so many financial professionals are now discussing the benefits of incorporating dividend-paying stocks as the core of an equity portfolio with their clients.

Dividend Growth: May Be a Key to Outperformance

Corporations that consistently grew their dividends have historically exhibited strong fundamentals, solid business plans, and a deep commitment to their shareholders.

In a recent research note on dividends, Ned Davis Research explains the current outlook for dividend-paying stocks by saying, "after a brief period of underperformance, Dividend Payers tend to outperform following the end of recessions. They have outperformed this cycle, but **not nearly by the degree they have historically**" (emphasis in original). Ned Davis concludes by saying, "Stocks that have increased dividends have tended to outperform over the long run." (Source: Is The Dividend Story Overdone?, Ned Davis Research, 11/16/11).

FIGURE 8 Returns of S&P 500 Index[1] Stocks by Dividend Policy: Growth of $100 **(1/1972–9/2011)**



Data Source: Ned Davis Research, 10/11.

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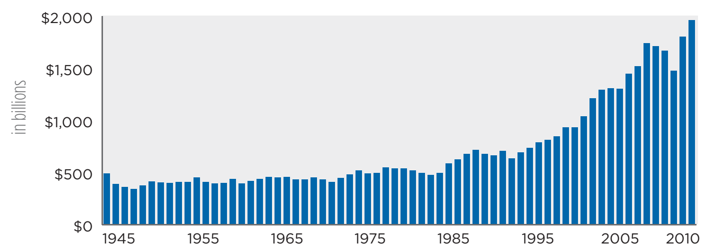
The Future for Dividend Investors

Trend 1: High Corporate Cash Could Bode Well for Dividends

Despite the Great Recession, corporations have been accruing record profits, and their balance sheets have swelled as a result. Over the past 10 years, cash on corporate balance sheets has doubled. Corporations can utilize this excess cash in a variety of ways, such as by expanding their business or by making acquisitions. While these options may be attractive in some environments, during uncertain times some corporations may be more cautious and choose to hold on to their cash in case of another economic downturn. Companies may also choose to use excess cash to initiate a dividend or increase their existing dividend payouts.

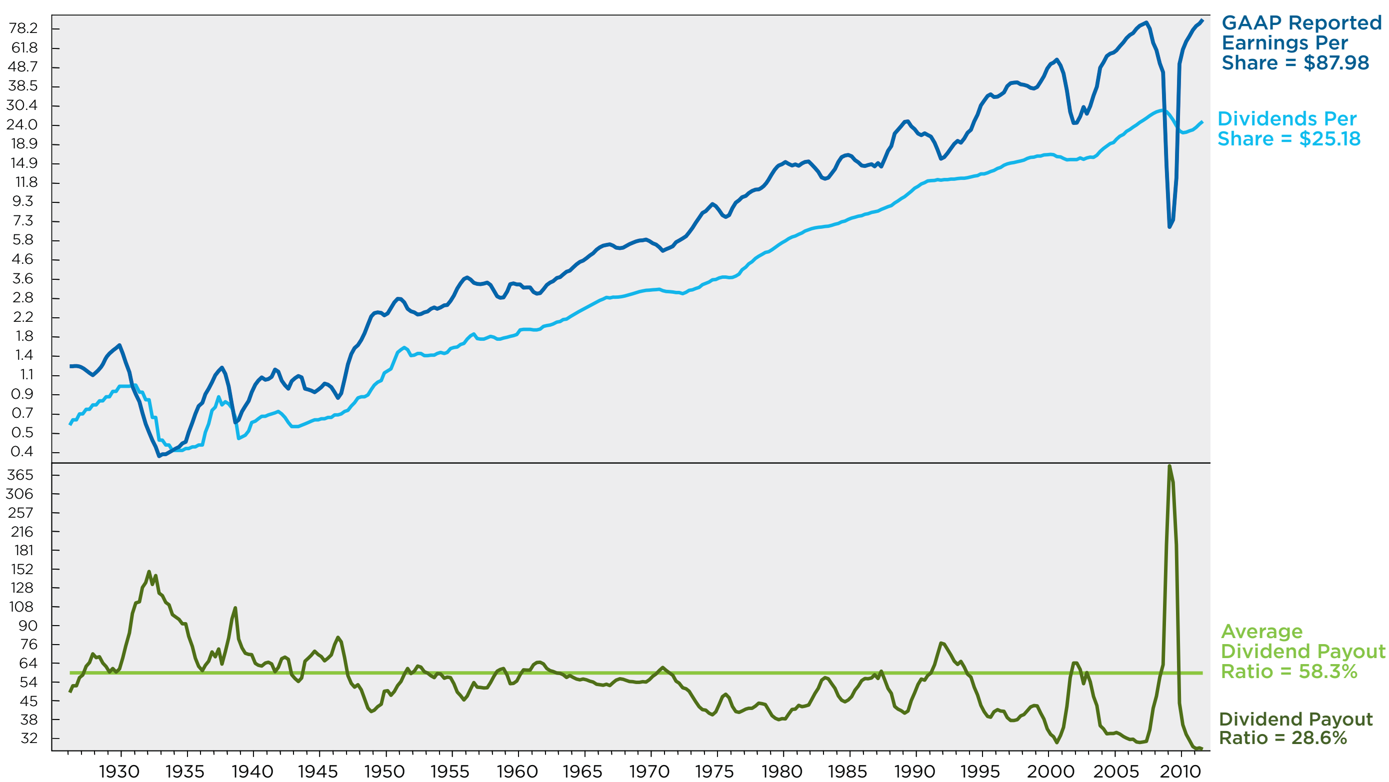
FIGURE 9 Record Levels of Cash on Corporate Balance Sheets



Data Source: Federal Reserve, 10/11. Numbers are adjusted for inflation.

Figure 10 shows the confluence of two positive trends that could benefit dividend investors: record-high corporate profits for S&P 500 companies coupled with record-low payout ratios. The average dividend payout ratio over the past 85 years has been 58.3%. As of September 30, 2011, the payout ratio stood at just 28.6%—leaving plenty of room for growth.

FIGURE 10 S&P 500 Dividend Payout Ratio Quarterly Data 3/31/1926 - 9/30/2011 (log scale)



- S&P 500 Index GAAP Reported Earnings Per Share
- S&P 500 Dividends Per Share
- Dividend Payout Ratio % (Trailing 4Q Cash Dividends/Trailing 4Q Reported Earnings)
- Average Dividend Payout Ratio

Earnings reflect estimate for latest quarter until actual earnings are released.

Data Source: Ned Davis Research and Zacks Institutional Services, 12/11.

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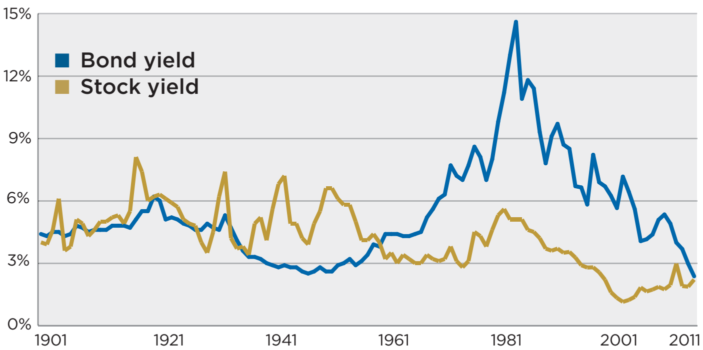
Trend 2: Low Bond Yields Could Bode Well for Dividends

With interest rates currently at low levels, dividend-paying stocks may be appealing to many investors who are seeking yield. For example, retiring baby boomers who are searching for income-producing investments and institutional investors seeking yield may find dividend stocks more attractive than today's low-yielding bonds.

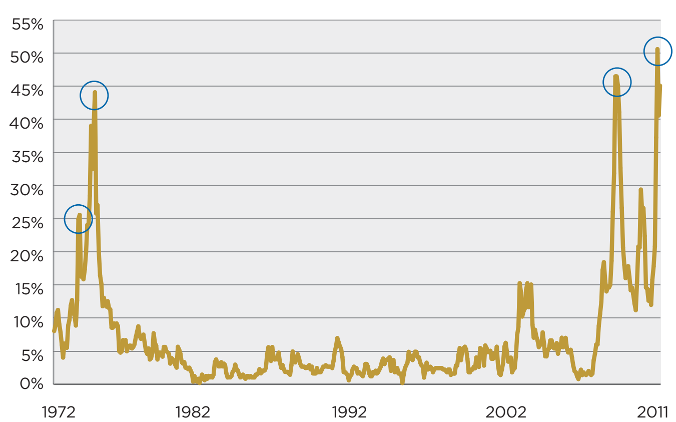
FIGURE 11 U.S. Stock Dividends Versus Corporate Bond Yields (1/1/1901–10/31/2011)



Sources: Bond data: S&P High Grade Corporate Bond (1901-1968), Citigroup High Grade Corporate Bond (1969 – 1972), Barclays Capital Govt/Corp Bond (1973 – 1975), Barclays Capital Aggregate Bond (1976 – 2010); stock data: Cowles Commission All Stocks (1901 – 1925), S&P 500 (1926 – 2011)

As of November 30, 2011, 45% of the stocks in the S&P 500 Index[1] have dividend yields higher than the 10-Year U.S. Treasury. We experienced similar readings in December 2008 through February 2009, but prior to this, stocks haven't yielded this much relative to bonds since December 1974 (see Figure 12).

FIGURE 12 Percentage of S&P 500 Stocks with Dividend Yields Greater than 10-Year Treasury Yields
4/30/1972 - 11/30/2011



Data Source: Ned Davis Research, 12/11.

Recent data indicate that institutional investors have already begun to take notice. As of December 31, 2010, the amount of institutional assets in U.S. dividend-focused strategies stood at $36.1 billion. This number grew significantly to $54.6 billion as of September 30, 2011—an increase of 51%.[6]

Trend 3: Financial Repression and Institutional Investors

The Federal Reserve has held interest rates at a record-low rate of 0-0.25% since 2008 and has a strong incentive to keep the rate low even after the economy begins to pick up steam. The Fed has already stated openly that they don't anticipate raising the short-term federal funds rate until mid-2013 at the earliest.

We generally think of monetary policy as a catalyst to help accelerate or decelerate economic activity, but it can also be used for other purposes. By keeping interest rates low, the Fed helps keep interest payments on the national debt low. In other words, low interest rates benefit not only businesses and consumers who want to borrow money, but also the biggest debtor in the world: the U.S. government.

Low interest rates benefit debtors and punish savers. Investors who have money in CDs,[7] money markets,[8] and savings accounts[9] are receiving startlingly low rates. Meanwhile, low interest rates make it easier for the U.S. government to make payments on outstanding debt, and these lower payments make severe austerity measures less necessary—as long as the U.S. government doesn't continue to run up new debt while it tries to deleverage.[10]

Institutional investors aren't likely to continue accepting these low yields indefinitely. For example, how long can a pension plan with an actuarial discount rate of 6% or higher continue to accept 10-Year U.S. Treasury Bonds[11] that yield 2% to 3%?

Institutional investors who have identified the trend toward financial repression have numerous options, including high-yield bonds,[12] bank loans,[13] sovereign debt of foreign countries,[14] REITs,[15] and dividend-paying stocks.[16,17]

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Summary

Dividends have historically played a significant role in total return, particularly when average annual equity returns have been lower than 10% during a decade.

Stocks in the highest quintile of dividend yields have historically underperformed stocks in the second quintile. Therefore, investors should only use yield as one consideration when selecting a dividend-paying investment.

Furthermore, dividend growers and initiators have historically provided greater total return with less volatility relative to companies that either maintained or cut their dividends.

Trends that bode well for dividend-paying stocks include historically high levels of corporate cash, historically low bond yields, and baby boomers' demand for income that will last throughout retirement.

Today's historically low interest rates are leading to financial repression as a way for the U.S. government to help reduce the deficit without severe austerity measures. This may lead institutional investors to consider dividend-paying stocks as a strategy in this yield-starved environment, which could lead to significant increased demand for dividend-paying stocks and strategies.

Investing in mutual funds entails market risks. The return and principal value of mutual funds will fluctuate so that shares, when redeemed, may be worth more or less than their original cost.

Indices are unmanaged and unavailable for direct investment.

[1] The S&P 500 Index is a composite of the 500 largest companies in the United States. The Index is unmanaged and not available for direct investment.

[2] The Dow Jones Industrial Average (DJIA) is an unmanaged, price-weighed index of 30 of the largest, most widely held stocks traded on the NYSE.

[3] The Russell 1000 Index represents the highest-ranking 1,000 stocks in the Russell 3000 Index, which represents about 90% of the total market capitalization of that Index. The Russell 1000 Index has a weighted-average market capitalization of $81 billion; the median market capitalization is approximately $4.6 billion, and the smallest company in the Index has a market capitalization of $1.8 billion.

[4] Beta is a measure of risk that indicates the price sensitivity of a security or a portfolio relative to a specified market index.

[5] Standard deviation measures the spread of the data about the mean value.

[6] Source: FundFire, "Managers, Institutional Investors Turn to Dividends," 12/21/01.

[7] A CD (certificate of deposit) is a savings certificate entitling the bearer to receive interest. A CD bears a maturity date, a specified fixed interest rate and can be issued in any denomination. CDs are insured up to $250,000 per depositor by the Federal Deposit Insurance Corporation (FDIC) or the National Credit Union Association (NCUA).

[8] Money market funds are not insured or guaranteed by the Federal Deposit Insurance Corporation (FDIC) or any other government agency. Although the funds seek to preserve the value of the investment at $1.00 per share, it is possible to lose money by investing in the funds.

[9] A savings account is an account provided by a bank for individuals to save money and earn interest on the cash held in the account. Savings accounts are typically insured by the Federal Deposit Insurance Corporation (FDIC).

[10] Source: National Bureau of Economic Research Working Paper, "The Liquidation of Government Debt," 3/11.

[11] U.S Treasury Bonds are backed by the U.S. government and are guaranteed as to the timely payment of principal and interest. This guarantee does not apply to the value of fund shares.

[12] High-yield securities, or "junk bonds," are rated below-investment-grade because there is a greater possibility that the issuer may be unable to make interest and principal payments on those securities.

[13] Bank loans are below-investment-grade, senior secured, short-term loans made by banks to corporations. They are rated below-investment-grade because there is a greater possibility that the issuer may be unable to make interest and principal payments on those securities.

[14] A government bond is a bond issued by a national government denominated in the country's own currency. Bonds issued by national governments in foreign currencies are normally referred to as sovereign bonds. Timely payment of interest and principal payments on sovereign debt is dependent upon the issuing nation's future economic health and taxing power.

[15] A REIT, which stands for Real Estate Investment Trust, is a company that owns or manages income-producing real estate. REITs are dependent upon the financial condition of the underlying real estate. Risks associated with REITs include credit risk, liquidity risk, and interest-rate risk.

[16] A stock is an instrument that signifies an ownership position (called equity) in a corporation, and represents a claim on its proportional share in the corporation's assets and profits. Dividends are a distribution of a portion of a company's earnings, decided by the board of directors, to a class of its shareholders. There are no guarantees connected with the dividend payouts for dividend-paying stocks.

[17] Sources: Pensions and Investments, "Institutional investors pick needs over peer comparisons," 9/28/11 and Barron's, "How to Get Safe Annual Payouts of 7%," 11/21/11.

You should carefully consider investment objectives, risks, charges, and expenses of The Hartford Mutual Funds before investing. This and other information can be found in the Fund prospectuses or summary prospectuses, which can be obtained from your investment representative or by calling 888-843-7824. Please read them carefully before you invest or send money.

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