

# The Dividend Trap

## Why Chasing Yield Can Lead Investors Astray

The allure of yield is powerful. Investors naturally gravitate toward it, often elevating yield above all other considerations as the clearest indicator of investment appeal. Yet, this fixation can lead to disappointing outcomes. Nowhere is this more evident than in the world of business development companies (BDCs), where dividend yield dominates marketing decks, analyst reports and investor screens. The reality is that dividend yield merely reflects a fund’s distribution strategy, not its earnings, and offers no insight into whether long-term value is being created for shareholders. To truly understand BDC value, investors need to look beyond yield.

### The Disconnect: Yield vs. Return

For income-oriented investors, dividend yield often commands outsized attention, yet it offers little insight into the value a manager is actually creating. The problem is that dividend policy and fundamental value creation do not always move in lockstep. When payout decisions drift away from underlying fundamentals, headline yield becomes a misleading guide.

Let’s look at actual results from two publicly traded BDCs over the past three years. BDC “A” reported an average dividend yield of 11.7% on net asset value (NAV), while BDC “B” had a lower yield of 9.6%. If you were chasing yield, BDC “A” might seem like the obvious choice. But net returns tell a different story.

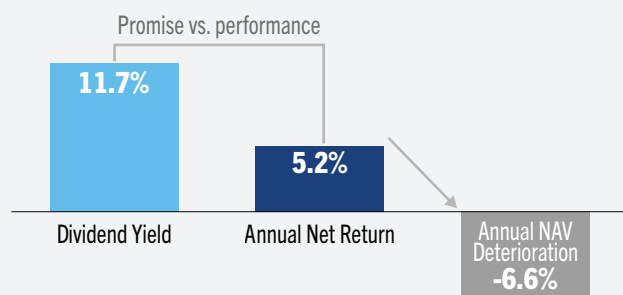
If we look at economic value creation (e.g., with starting NAV as our cost and dividends received and ending NAV as our return), BDC “B” delivered annual net return of 10.5%, double BDC “A’s” 5.2%. The promise vs. the performance is clear: dividend yield was a poor predictor of what investors actually earned. When a BDC’s earnings fall short of its dividend, fund NAV erodes; that is, the principal value of an investor’s capital declines. In this example, the higher yield on the screen masked underlying credit risk, ultimately eroding actual investor returns.

Exhibit 1

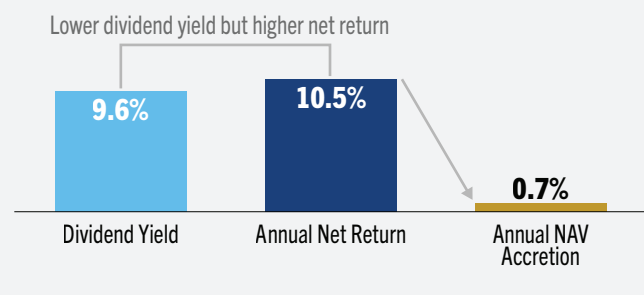
### Promise vs. Performance

#### Three-Year Dividend Yield Compared to Annual Net Return

##### BDC “A” Actual Results



##### BDC “B” Actual Results



Source: Golub Capital internal analysis using data from KBW Research’s BDC database. Performance metrics were calculated over a three-year performance period from Q3 2022 to Q2 2025. Dividend yield is calculated as the average quarterly dividend yield over the period. Annual net return is calculated as the average economic return, defined as the BDC’s change in NAV per share plus total dividends per share received over the period divided by beginning period NAV per share. Annual NAV deterioration and accretion is calculated as the difference between the beginning and ending period NAV per share divided by the period.

# Understanding BDC Dividend Yield

Let's clarify what dividend yield means in the BDC universe. We define dividend yield as the annualized cash distribution of the fund divided by its NAV. The headline yield says nothing about the sustainability or quality of those payments. How a BDC manager chooses to fund its dividend, whether from genuine earnings or by returning capital, can have lasting consequences for shareholder value.

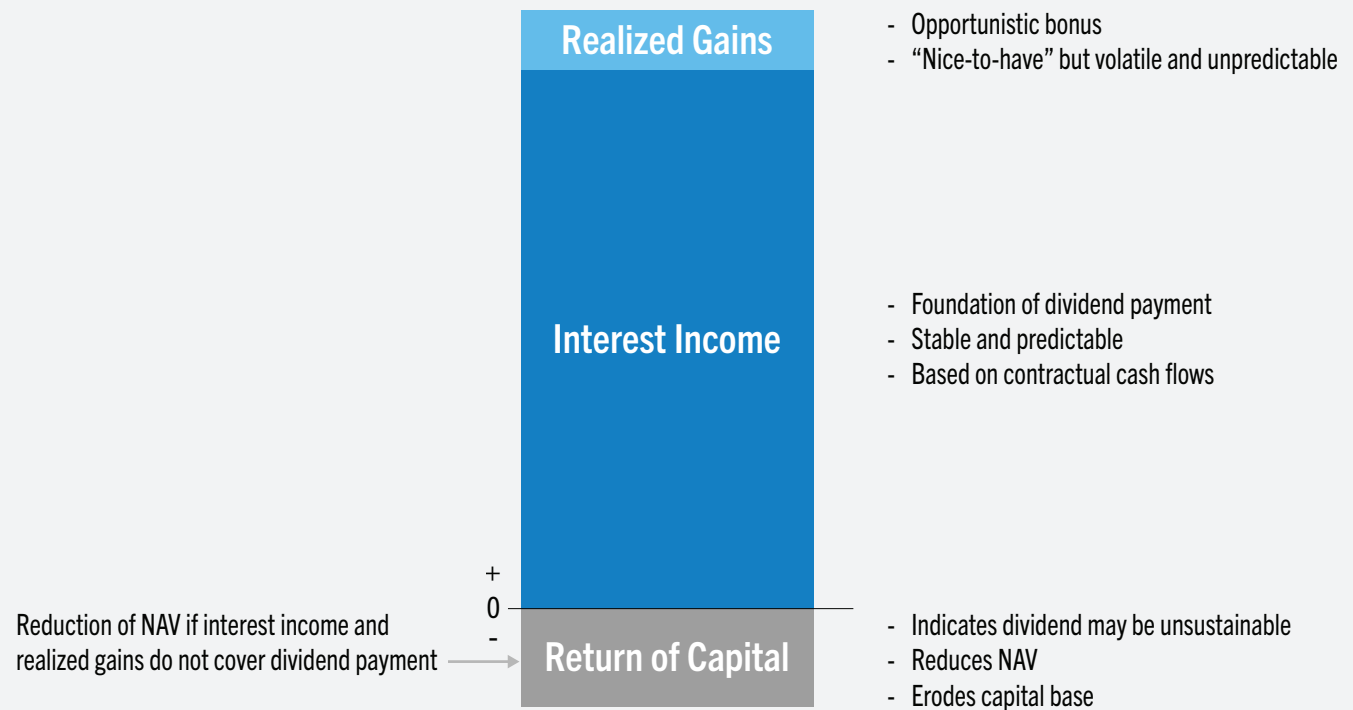
BDCs can fund dividends in several ways: through investment income or realized gains or, when those fall short, by returning

shareholder capital. This last approach erodes NAV and reduces future earnings power. Conversely, a BDC that consistently earns more than it pays out can grow NAV and increase future earnings. Dividend yield alone doesn't tell us how well the manager is performing. It simply reflects the fund's capital distribution policy, which may be fully funded by earnings or underfunded, requiring some form of return of capital to sustain it.

Exhibit 2

## Not All Dividends Are Created Equal

### Dividend Funding (and De-Funding) Sources



Source: Golub Capital.

# What Really Drives BDC Returns

So, what should investors focus on when considering a BDC allocation? The answer is net returns. At their core, BDC net returns are driven by income and reduced by credit losses. The income return, before accounting for credit losses, is the primary support for the dividend. However, it is the management of credit losses that truly distinguishes manager skill and drives performance dispersion across BDCs.

Consider the actual results from publicly traded BDC "A." Its income yield of 11.6% was roughly in line to support its dividend distribution of 11.7%. However, annual net credit losses of -6.4% cut deeply into performance, reducing net

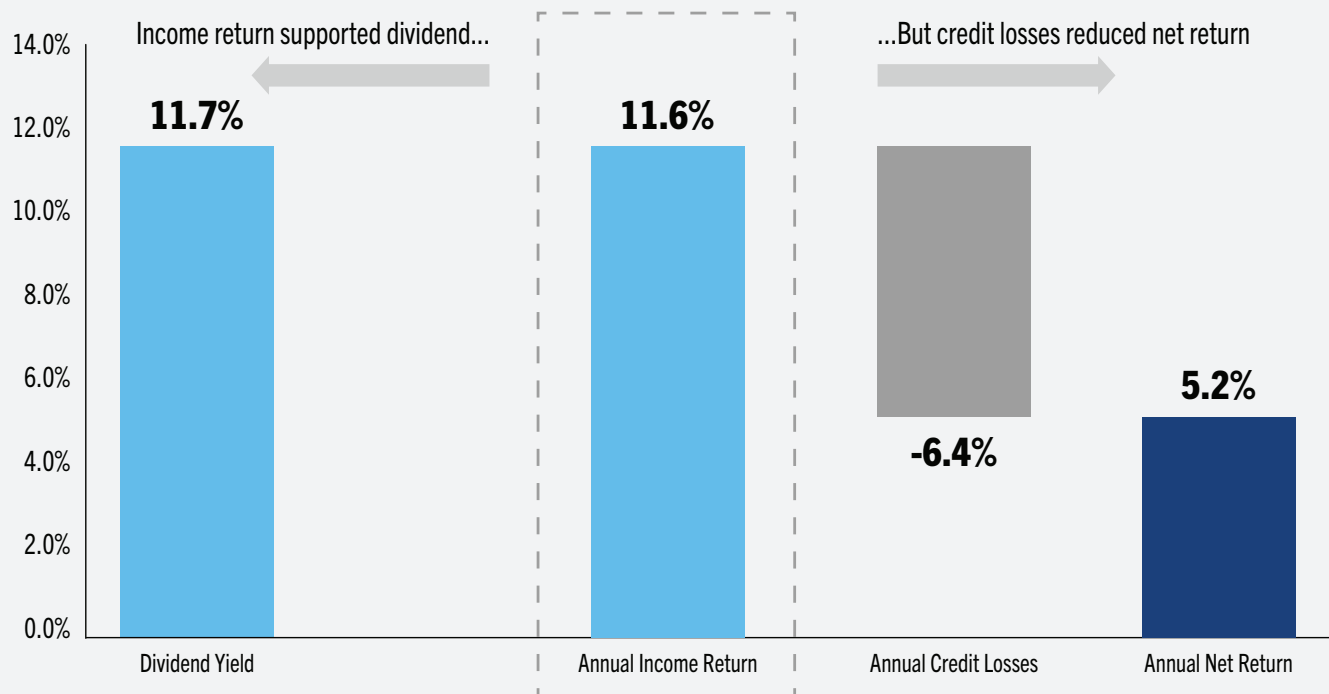
returns and eroding NAV by an amount nearly equal to those losses.

Managers who keep credit losses low are able to preserve NAV and protect shareholder capital. Net returns, not headline dividend yield, are the true measure of manager performance. Ultimately, a manager's ability to minimize credit losses is what distinguishes superior performers from the crowd.

Exhibit 3

## Credit Losses Distinguish Manager Skill and Drive Performance

### BDC "A" Net Return Composition



Source: Golub Capital internal analysis using data from KBW Research's BDC database. Performance metrics were calculated over a three-year performance period from Q3 2022 to Q2 2025. Dividend yield is calculated as the average quarterly dividend yield over the period studied. Annual income return is calculated as the average quarterly net investment income return over the period. Annual credit losses are calculated as the difference between the annual net investment income return and net income return over the period. Annual net return is calculated as the average economic return, defined as the BDC's change in NAV per share plus total dividends per share received over the period divided by beginning period NAV per share.

# History Shows: Yield Is Not Predictive

One takeaway is to be cautious when assessing BDCs based solely on their dividend yield. Over the past three years, BDCs with both the highest yield and the lowest yield based on quartile dividend yields generated lower net returns. Some faced credit headwinds; others simply struggled to generate loans with sufficiently high spreads.

The strongest results were achieved by BDC managers who maintained sustainable dividend distributions while managing credit headwinds. Consistent outperformance has come from BDCs that strike a prudent balance, supporting dividends with genuine earnings rather than taking on excess risk or returning capital.

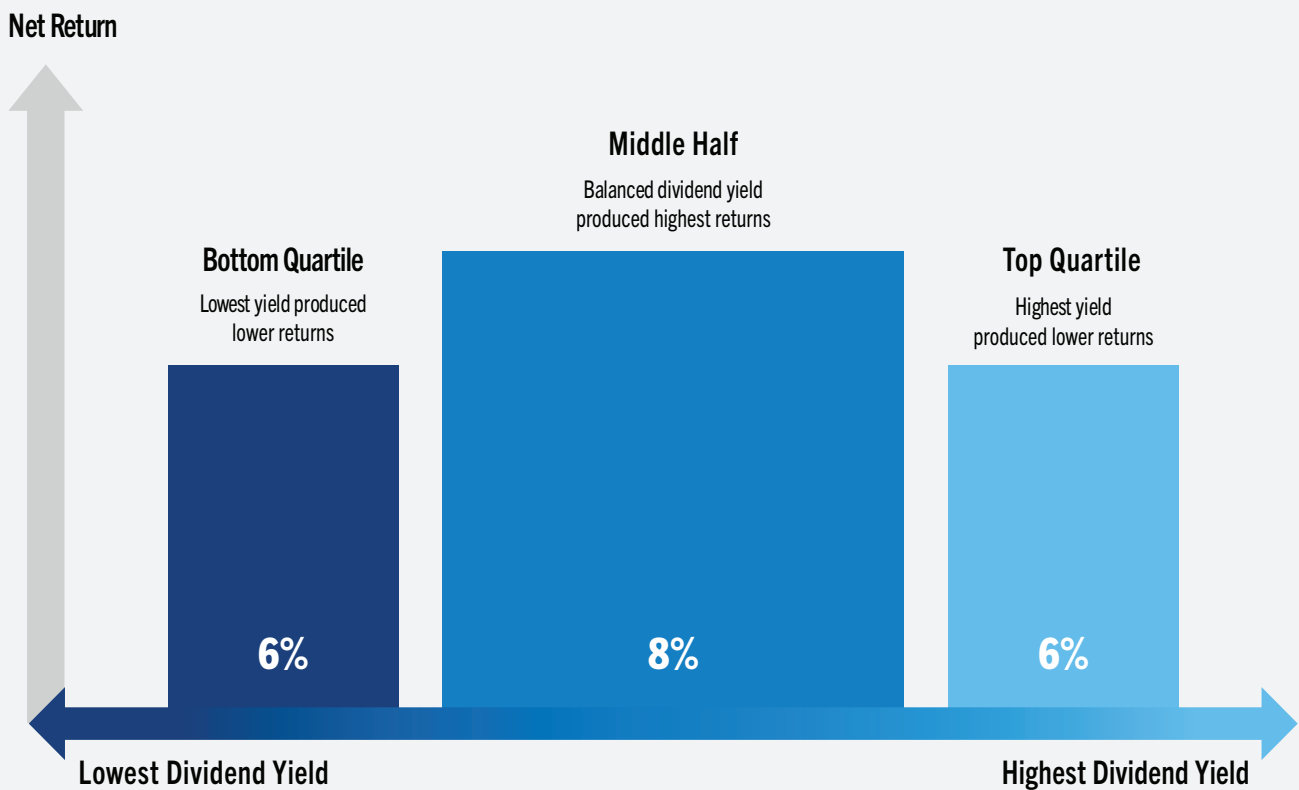
High dividend yields should be met with skepticism and a critical eye. Elevated yields could signal that managers are taking on greater credit risk to support above-market payouts. This risk may not be obvious at first, but over time higher credit losses erode investor capital and undermine returns.

**The lesson is clear:** Sustainable results come from disciplined credit management and real earnings generation (after credit losses), not from chasing the highest yield.

Exhibit 4

## A Balanced Dividend Approach Has Proven Successful

### BDC Net Returns by Dividend Yield Quartile



Source: Golub Capital internal analysis using data from KBW Research's BDC database, which tracks the three-year return performance from Q3 2022 to Q2 2025. BDC net return is calculated as the BDC's change in NAV per share plus total dividends per share received over the period divided by beginning period NAV per share. The data set excludes internally managed BDCs, venture lending BDCs and those with 25% or more equity exposure, resulting in a total of 32 BDCs. Past performance does not guarantee future results.

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