

# DIVIDEND INVESTING: A PRIMER



RICHARD C. YOUNG & Co. LTD.  
INVESTMENT ADVISORS

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*One of the most persuasive tests of high quality is an uninterrupted record of dividend payments going back over many years. A record of continuous dividend payments for the last 20 years or more is an important plus factor in a company's quality rating.*

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*For the vast majority of common stocks, the dividend record and prospects have always been a most important factor in controlling investment quality and value. In the majority of cases, the common has been influenced more markedly by the dividend than by reported earnings. In other words, distributed earnings have had a greater weight in determining market price than have retained earnings.*

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-Benjamin Graham, *The Father of Value Investing*

A painful lesson learned by many investors since the turn of the century is to not rely solely on capital appreciation for stock-market gains. Investors who pursued speculative gains during the dot-com bubble and in the years leading up to the real-estate collapse were left not only with decimated portfolios, but with portfolios that produced little annual income.

The ultralow-yielding NASDAQ index has more than doubled over the last five years, but the reality for NASDAQ investors is that during this century the index has underperformed even bank CDs. That's a decade and a half with very little return. And if you think you can avoid a similar fate because you buy the “safer” non-dividend-payers, consider this. During a 16-year period from 1965 to 1981, the blue-chip Dow Jones Industrial Average fell 10% in price. Sixteen years is most of a retirement for many investors. The performance of the NASDAQ and the Dow in these two periods is a sobering reminder that stock prices can remain depressed for agonizingly long periods.

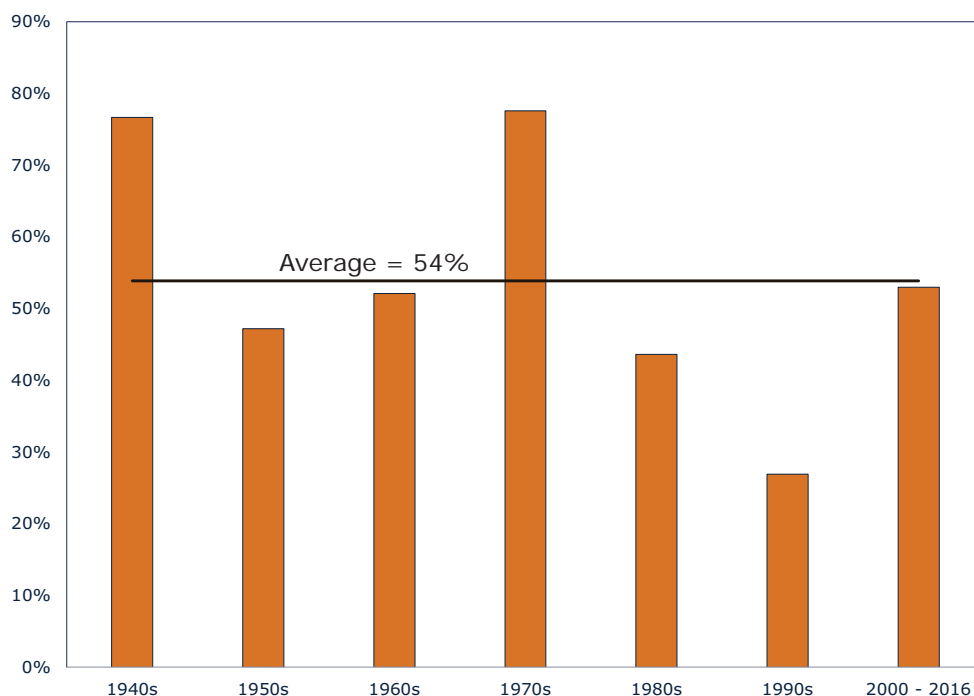
### Give Dividends a Starring Role

A possible solution to these long dry spells is to give dividends a starring role in your portfolio. Dividends have historically been a vital component of long-term stock-market returns. Over short time frames and during long bull markets, dividends may seem

trivial—but as Figure 1 illustrates, over the last seven decades, dividends have accounted for an average of 54% of each decade’s stock-market returns. In the first 15 years of the 21st century, when the NASDAQ barely gained any ground, high-dividend-payers (highest yielding quintile) compounded investors’ money at 7%. And during that 16-year period from 1965 to 1981, when the Dow fell in price, high-dividend-yielding stocks earned a compounded annual return of 8.1%.

Figure 1: S&P 500 Share of Return From Dividends

**Dividends and the reinvestment of dividends have historically accounted for over half of stock market returns.**



When you measure over multi-decade periods, the impact of dividends on investment returns becomes clearer. Over the last 40 years, dividends and the reinvestment of dividends have accounted for almost 70% of the S&P 500’s total return.

### A Steady Stream of Income

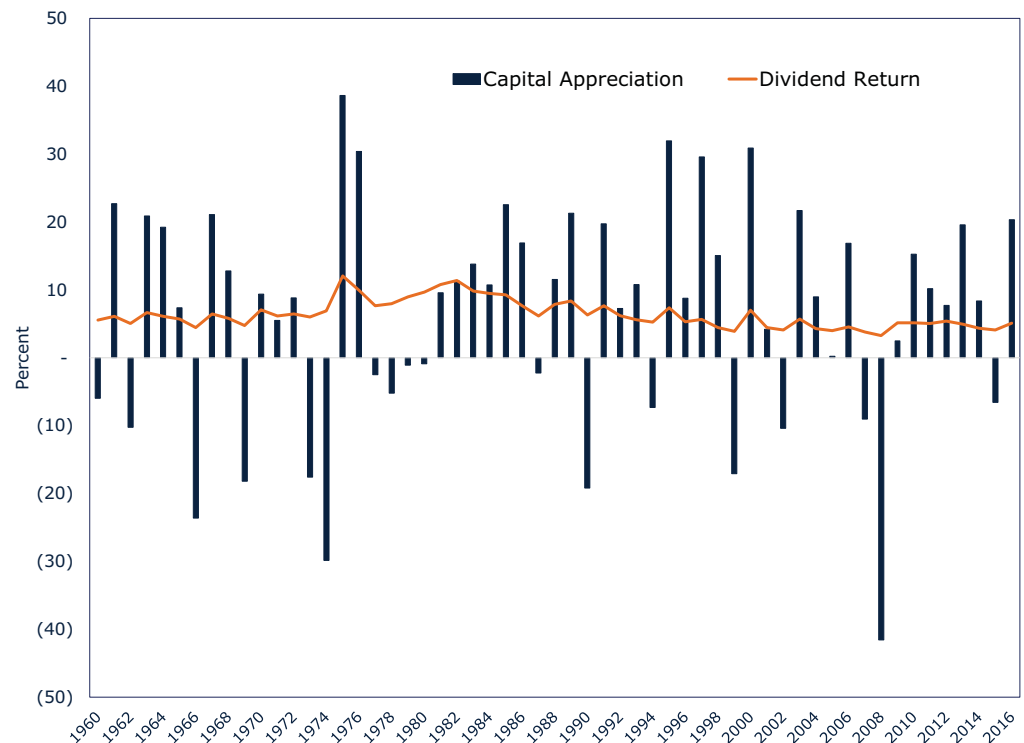
Dividend stocks, and especially high-dividend-yielding stocks, have appeal for all types of investors. A continuous stream of dividends can be used for living expenses (ideal for retirees) or reinvested at a lower share price, resulting in higher future-dividend payments (ideal for long-term wealth accumulation). A steady stream of cash also makes

it easier for investors to avoid the emotionally charged decisions that tend to sabotage portfolios in down markets.

Figure 2 compares the capital-gains component of returns to the dividend component of returns for high-yielding stocks. Note the stability of dividend returns compared to capital gains.

Figure 2: Dividend Return vs. Capital Appreciation

**The stability of dividend returns can offer comfort to retired investors.**



### Reduce Risk with Dividend Stocks

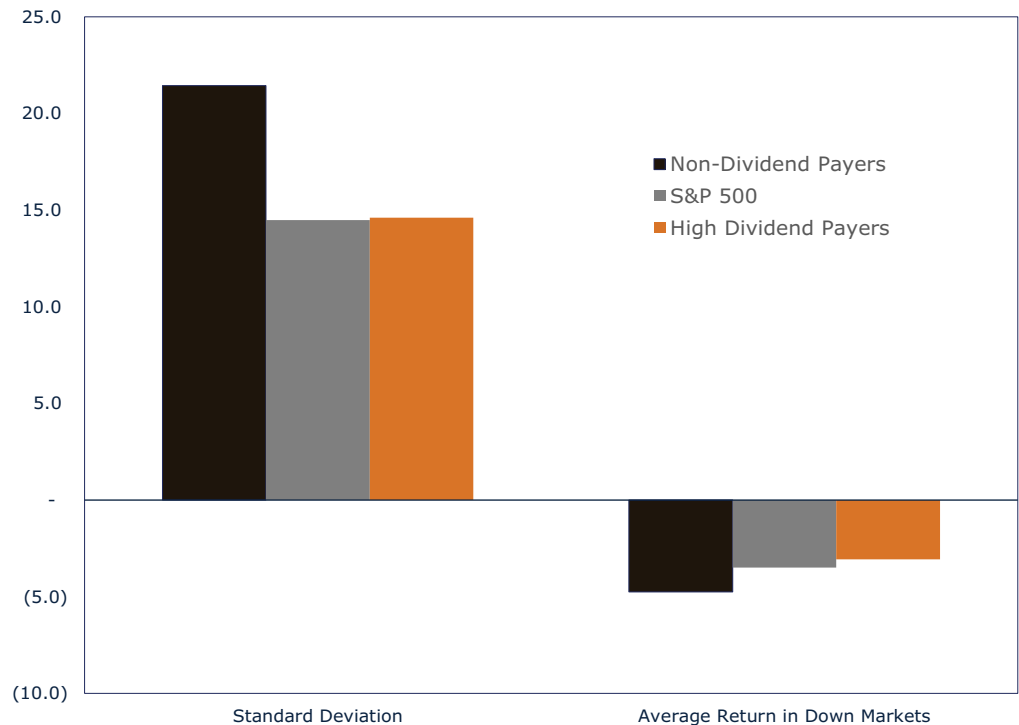
What's more, dividends help reduce portfolio volatility. Figure 3 (next page) shows that high-yielding stocks have been less volatile than non-dividend-paying stocks. And high-yielders have held up better in down markets than both non-dividend-payers and broad-based stock-market indices such as the S&P 500.

### Dividends: A Shortcut to Quality

A dividend strategy may also help you avoid many of the pitfalls that wreak havoc on even the most seasoned investors' portfolios. Dividend-paying companies are often

Figure 3: High Dividend Payers Less Risky

**Historically, high dividend payers lose less in down markets.**



**Dividend payers are often durable businesses with strong balance sheets.**

more durable businesses than non-dividend-payers. Payers are also more likely to operate in industries with higher barriers to entry and have stronger balance sheets than non-dividend-payers. And because there is a stigma associated with cutting dividend payments, the consistent payment of dividends is a signal of management confidence in the future prospects of a company. This is especially true of companies that raise dividends. Management teams rarely commit to higher dividend payments unless they are confident the dividends can be maintained.

Cold, hard cash in the form of quarterly dividend payments may also be a sign of strong corporate management. Who can forget the accounting frauds of Enron, WorldCom, and Tyco and their impact on many retirement portfolios? Not a single company in the group paid a meaningful dividend. Companies can manipulate and fake earnings by using creative accounting techniques, but regular dividend payments can't be faked.

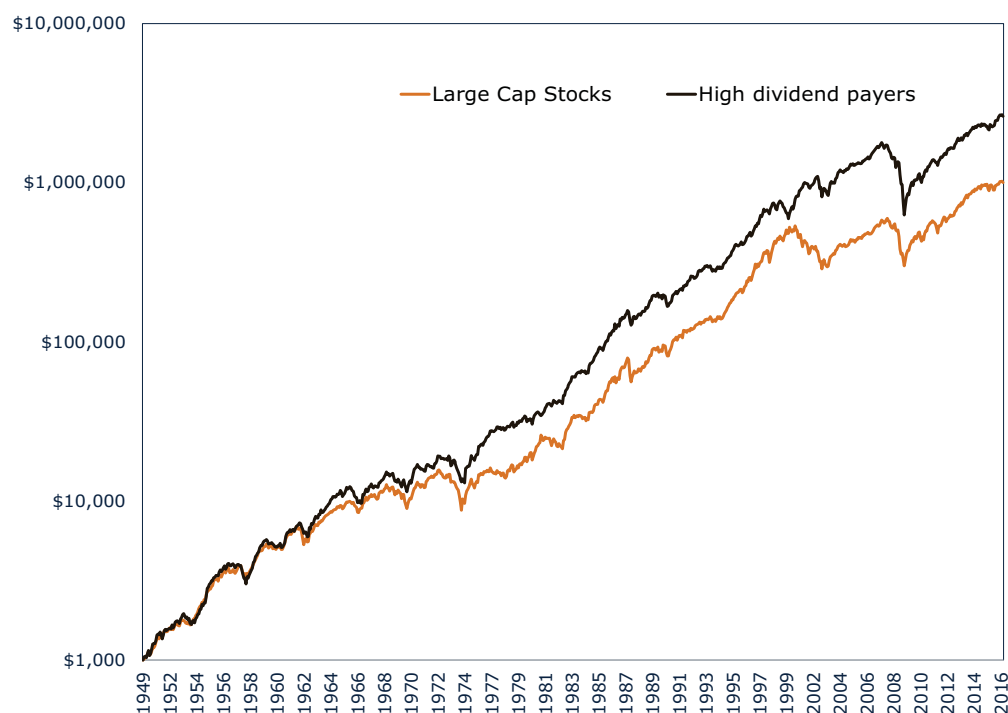
### A Free Lunch?

What is the trade-off for consistent income, lower risk, and higher quality? Would you believe the possibility of higher long-term returns? Although one might expect a

high-quality, low-risk strategy to generate lower long-run returns, the opposite has been true. Over the long run, high-yielding stocks have outperformed the broader market. Not every year, of course, but over time, the highest-yielding quintile (top 20%) of stocks beat the market by a substantial margin (Figure 4).

Figure 4: Large-Cap. Stocks vs. High Dividend Paying Stocks

**High dividend payers turn \$1,000 into \$2.6 million vs. \$1 million for large-cap stocks—a difference of \$1.6 million.**



### Faster Earnings Growth from Dividend-Payers

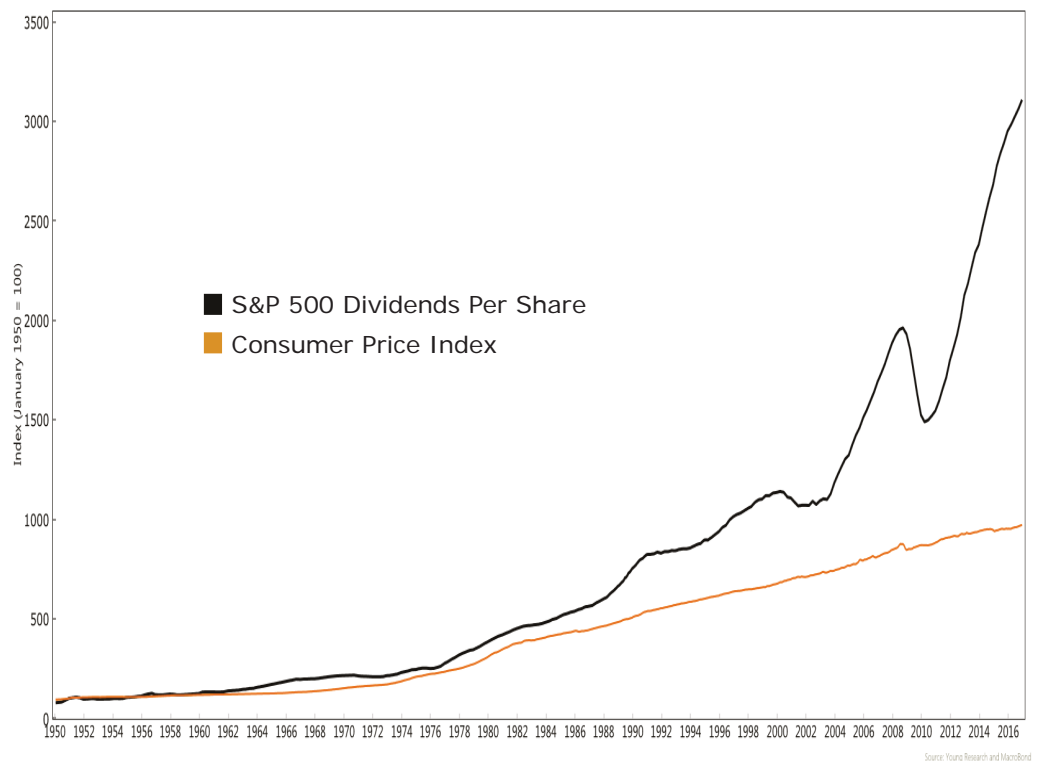
If you have avoided dividend-payers in the past because you've assumed they are boring businesses with low growth prospects, you may be surprised by the historical facts. Historically, companies that returned more earnings to shareholders in the form of dividend payments had greater earnings growth. Why? Is it not true that the fastest-growing companies often pay no dividends at all? Indeed it is, but high dividend payments limit the amount of cash management teams have at their disposal. The resulting scarcity of capital forces CEOs to pursue only those projects offering the most promise. At non-dividend-paying companies, where retained earnings are abundant, management teams are often more likely to make questionable acquisitions or invest in marginal expansion projects that hurt profitability.

## Dividend-Payers As an Inflation Hedge

With global central banks pumping trillions of dollars into the global financial system while holding interest rates near zero, the risk of accelerating inflation appears higher than it has been in decades. Stocks shouldn't be the first asset class you think of for inflation protection, but they do have an important inflation-fighting role to play in your portfolio.

Stocks tend to maintain their purchasing power during inflationary periods because they are real assets. When inflation rises, the revenues, earnings, and dividends of companies tend to rise as well. Figure 5 shows that dividends per share for the S&P 500 have outpaced inflation by a wide margin.

Figure 5: S&P 500 Dividends per Share vs. CPI



**Dividend payers  
help fight inflation.**

## Don't Speculate: Invest

If you've harbored doubts about a dividend strategy, we hope we have established that for investment purposes (as opposed to speculation) a dividend strategy can be a winning approach for you. Dividend stocks provide a steady stream of income for compounding, they are often higher-quality businesses than non-dividend-payers, they

historically have been less volatile in down markets, and for investors who have a time horizon that is longer than a year or two, dividend-payers offer the prospect of market-beating returns.

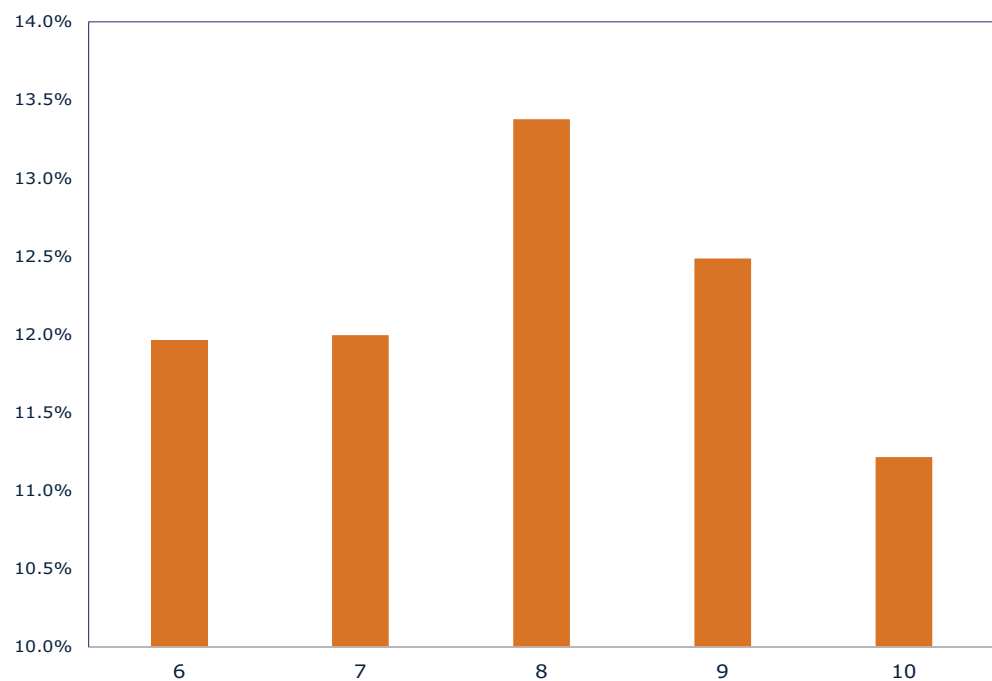
## Getting Started with Dividend Stocks

Once you have made the decision to pursue a dividend strategy, how do you choose the best dividend stocks? Should you buy the highest-yielding stocks, or should you favor those with the highest dividend growth? Should you stick to large-capitalization dividend stocks or pursue small-capitalization dividend stocks as well? Should you limit purchases to U.S. stocks or invest abroad?

Since dividend-payers beat non-dividend-payers, one might assume that the higher the dividend yield, the better. But that isn't always true. Yield alone is not the best indicator of future stock performance. A high dividend yield can be a warning sign that the dividend may be unsustainable, or that the dividend-paying company is not growing. The historical record shows that an investment strategy that buys the highest-yielding 10% of the stock market and rebalances annually delivers investment returns that trail stocks with high, but not the highest, yields.

Figure 6 shows the compound annual return over the last 45 years of five portfolios formed based on dividend yield. As you can see, the portfolio including stocks from the

Figure 6: Highest Yielders Not Best



**Buying high, but not the highest yielders has historically been a better investment strategy than buying the highest yielders.**



highest-yielding group actually earned less than did the other four.

**Companies that make regular dividend increases, have historically beaten companies that don't by as much as 34%.**

### Dividend Growth is Key

At Richard C. Young & Co., Ltd., an important feature of our investment strategy is crafting dividend portfolios that include companies with high dividend yields, a history of regular dividend payments, and a record of consistent dividend increases. Studies by market research firm Ned Davis show that over the last four decades, companies that have increased their dividends regularly have outperformed dividend-payers lacking dividend growth, by as much as 34%. The combination of a high dividend yield today and higher dividend payments tomorrow can be a potent tonic for investment portfolios.

### A Focus on Dividend Increases

To build a portfolio of what we believe are the best dividend paying stocks, we focus our domestic stock investing on companies that have increased their annual dividend payment for at least 10 consecutive years.

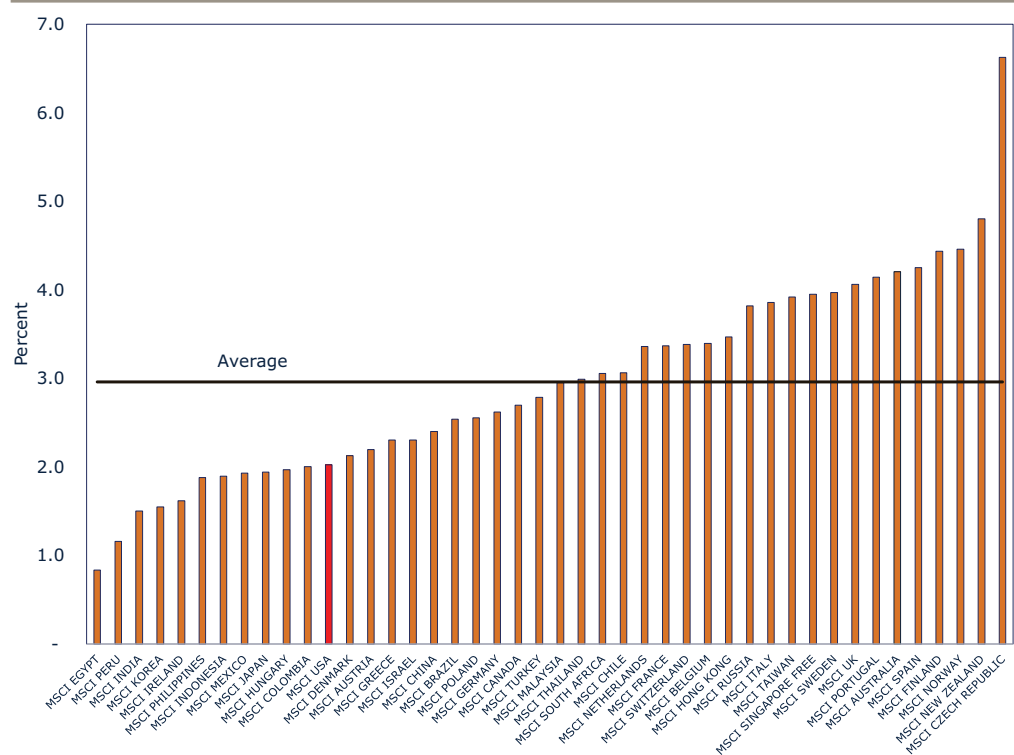
We also invest in international dividend payers for our clients. Foreign companies don't always adhere to the same dividend conventions as U.S. companies, so restricting our investment universe to only companies that have increased their dividend for 10 consecutive years isn't practical. Instead we look for firms that have a dividend policy that calls for regular dividend hikes even if they don't occur every year.

For the dividend investor, foreign markets can offer compelling opportunities. There are many foreign markets where stocks consistently yield more than those in the U.S. Some even set minimum dividend-payout ratios for companies. Figure 7 (next page) shows that of the 44 countries in the MSCI All-Country World Index, the U.S. ranks 33rd in dividend yields. Savvy investors recognize that a global dividend portfolio can yield a much greater level of income than a domestic portfolio.

As you can see in the following chart, a well-crafted global dividend portfolio can significantly increase an investor's dividend income when compared to an investment in a broad U.S. stock market index.

Figure 7: MSCI Country Dividend Yields

**Savvy investors can boost income by investing abroad.**



### Take The Burden of Portfolio Management Off Your Shoulders

The strategies and insights we have shared with you in this report form the foundation of the equity investment strategy at Richard C. Young & Co., Ltd. We hope you have found this report informative. Our goal is to help you and your family achieve long-term investment success with comfort and confidence. If you like the sound of what a global dividend portfolio has to offer, Richard C. Young & Co., Ltd. can help. We manage global dividend portfolios for individuals, families, and businesses throughout the United States. Our portfolio minimum is \$500,000.

To schedule an appointment with one of our investment specialists, please click [here](#) or give us a call at 800-843-7273.

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