

Financially Speaking

With Trisha Arndt, CFP®

Modern Times Make Dividend Investing Popular Again

“Do you know the only thing that gives me pleasure? It’s to see my dividends coming in.” - John D. Rockefeller

Many years ago I remember my mother telling me that someday bell bottom pants would be popular again. I laughed hysterically at her, calling her old-fashioned and behind the times. After all, rolling your jeans tight at the ankle was the height of fashion and always would be, right?

A few years later “flare” pants, the modern version of bell bottoms, came into fashion and I had to eat my words. It seems mom was right after all.

Similarly, the technological advances of the last couple of decades have spawned all sorts of new investing styles. The notion of owning stock in companies that pay dividends became just as old fashioned as I once thought my mother’s bell bottoms were. After all, who cares about a 3% dividend yield when all you have to do is buy an internet IPO to double your money (or more)? Why look for companies with stable earnings and a history of dividend increases when you can simply subscribe to an on-line news letter, follow a few trend lines and day trade yourself to riches? And heavens knows there is no reason to pay for a money manager to research company fundamentals when you can simply own an exchange traded fund tracking some concentrated index and watch your earnings pile up.

Oops, maybe when things really hit the fan (as they did beginning in October of 2007) those old fashioned dividends don’t look so out of style after all.

Dividends are a means for companies to share excess cash with shareholders (i.e. the owners of the company). As companies make money they have several options of what to do with the profits and dividends are certainly not the only good one. Companies can also use cash to fund projects, acquisitions or research and development that will grow earnings down the line. An entire school of investing philosophy is dedicated to searching out “growth” companies that don’t yet pay dividends but are wisely utilizing their earnings. Growth investing has a place in many portfolios but a further discussion on that topic will have to be saved for another day.

Instead I want to focus on what I like to call “classic” investing. Just like buying that good quality black skirt that is timeless and can go with many other styles, there are companies that aren’t necessarily sexy or exciting but that have stable revenue streams, clean balance sheets and a history of returning profits to shareholders. Where once a 3% or 4% dividend yield was scoffed at as being insignificant, in a world like today when cash instruments have nominal yields only and you’d have commit to a ten year treasury

bond to get an interest rate of around a 2.5%, those dividend rates suddenly seem more interesting.

Just think, even if the stock price didn't move at all, you could still receive the dividends and theoretically get paid to wait for the economy (and stock market) to improve and grow again. If the stock is yielding 4% and you reinvest those dividends (i.e. allow them to automatically buy more shares of the stock) you could potentially compound your return further. And keep in mind that many companies increase their dividends regularly, potentially raising your annualized return as well. If you add in even a modest expectation for long term stock price appreciation then suddenly the return potential doesn't look so boring anymore.

Because the best dividend payers tend to be larger, well established companies with products and brands that are less affected by broader economic conditions (did you stop buying shampoo or macaroni and cheese in 2008?) their stock prices tend to be less volatile than the broader markets. That doesn't mean that the stock prices can't rise and fall however. Stocks do not come with principal guarantees so it is important that you know what the risks are before putting money in any type of investment. That being said, if a falling stock market was to bring the stock price down 10% over a year, and it was paying you a 5% dividend at the time, your investment value would have declined only 5% - the dividend provided some downside protection.

As the economy continues to try and churn its way out of the recession we will continue to see "new" styles of investing emerge that purport to be the best idea ever (gold speculating or hedge funds anyone?). While many styles of investing have merit and some may actually perform quite well at times, I suggest that you take another look at the classics. They never go out of style.

Forward-looking statements are not guarantees of future performance and involve certain risks and uncertainties which are difficult to predict. Past performance is not indicative of future results. All indices are unmanaged and investors cannot invest directly into an index. Diversification does not ensure against market risk.

Trisha Arndt, CFP[®], is president of Wealth Strategies of Wisconsin Ltd, 535 Half Mile Road, Ste 5B, Verona, 848-2400. Securities and Investment Advisory Services offered through Commonwealth Financial Network, member FINRA/SIPC, a registered investment adviser