

Dividend-paying stocks offer best current value

Dividend-paying stocks will be an increasing point of interest for investors in 2011. Many dividend payers are raising their payments to shareholders.

Favorable tax treatment has been extended for at least another two years on U.S. company dividends. And the growing wave of baby boomers seeking to boost their retirement income appears tempted by dividend payments compared to low payouts on traditional income-oriented investments like bonds and CDs.

Many investors figure you can buy dividend-paying stocks for the income and potentially get price appreciation for free, something that certainly is not available with bonds, CDs or other fixed-income investments.



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While investors should beware that the magnitude of downside stock market risk is much greater than downside risk of fixed-income investments, there are valid reasons to emphasize dividend-paying stocks in your investment mix.

DIVIDEND PAYERS HAVE PERFORMED BETTER

Over the past 40 years, stocks of companies that increase their dividends provide much higher returns than those that don't.

Research from Neil McCarthy and Emanuele Bergagnini of Oppenheimer Funds indicates that from January 1972 through September 2010, companies in the S&P 500 Index that increased dividends had an annual average return of 9.27

percent. Those that did not pay dividends returned 1.82 percent per year. Better yet, the companies that increased dividends also experienced about one third less fluctuation in market value. McCarthy and Bergagnini reset the list annually to add or remove companies to fit each category. There is not a way to invest specifically in this collection of companies but it provides a good general indication of the benefits of dividend-paying companies.

Many people believe that companies choose to begin paying dividends to shareholders when their business matures and they don't see terrific growth prospects from reinvesting in their business. But McCarthy and Bergagnini suggest that companies see even better profits coming in the future and are comfortable raising dividend payments to reward shareholders.

DIVIDEND GROWTH CAN OUTPACE INFLATION

The top 20 dividend-paying U.S. companies (by dollars distributed) in the Wisdom Tree Dividend Index, increased their dividends by an average of 10.1 percent from 2009 to 2010. Only one of the top 20 did not increase its dividend and it maintained the same dividend as the previous year. Overall, the dividend yield of the top 20 stocks averaged 3.78 percent.

INTERNATIONAL STOCK DIVIDEND YIELDS

The Russell 1000 Index measuring U.S. large company stocks had a dividend yield of 1.80 percent at the end of 2010. The MCSI EAFE Index, a proxy for large cap, developed market stocks outside of North

America, ended 2010 with a 2.93 percent dividend yield – 65 percent higher.

While increasing investment income by 65 percent is certainly attractive, international stocks do carry more risks.

EQUITY INCOME TOO IMPORTANT TO OVERLOOK
Since 1926, dividends have represented 45 percent of the total return of the S&P 500 Index. Over the recovery rally that is now nearly two years old, dividends have been much less influential than capital gains as the S&P 500 has risen 90 percent from its financial crisis lows through the end of January. Going forward, however, with more companies raising dividend payments and the pace of recovery moderating, dividends will be a bigger component. High-quality, dividend-paying companies seem to offer the best current value among global stock market segments.

Just remember that if it's income that you seek, the risk associated with stock dividends can be moderated by expanding your bond holdings to include foreign bonds, Treasury Inflation-Protected Securities, and corporate bonds as well.

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