

Dividend Stocks

Yankee Model Club

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Paying Dividends Is Discretionary

- Companies pay dividends out of their profits
- Companies don't guarantee they will pay dividends, but if they have a dividend program most are reluctant to cut them.

How Dividends Work

- Dividends are paid for each share of stock you own.
- The payouts are usually made on a regular schedule. The most common is quarterly.
- Sometimes companies issue special, one-time dividends.
- If you own 100 shares of a stock that pays quarterly dividends of 50 cents a share, you would receive \$50 each quarter for an annual dividend of \$200.

Benefits of Dividend Paying Stock

- They give you consistent quarterly income
- You can re-invest the dividends via DRIP (Dividend Reinvestment Program) and buy more stock each quarter.
- Provide a return when stock prices aren't increasing.
- Provide stability and diversity to balance a portfolio of more volatile growth stocks.

Other Benefits

- Provide confirmation of the company's financial condition. Companies might engage in fraudulent accounting practices, but they can't fake dividend payments.
- More flexibility with stocks that pay dividends than buying an annuity where you're locked into multiyear terms.
- Dividends that are "qualified" (by meeting IRS standards) are generally taxed at lower rates.

Defining Dividend Stocks

- Many stocks pay dividends but that's not the main reason people buy them.
- People buy dividend stocks because of the income they get; they're not expecting growth
- The stock price is stable or might increase slowly.

Dividend Yield

- Is the ratio of a stock's annual dividend to the current stock price.
- The yield is based on the stock's current price, so yield can vary from day to day.
- The average dividend yield of stocks in the S&P 500 ranges between about 2% and 4%.
- Dividend stocks may yield 4%-6% or more

Ways to Invest in Dividend Stocks

- There are 3 main options for investing in dividend stocks:
- Individual stocks
- Dividend exchange-traded funds
- Dividend mutual funds
- Individual stocks may be the lower cost option because you won't have to pay the management fees of ETFs and mutual funds.

High Yield AND High Quality

- When choosing dividend stocks don't just focus on the dividend.
- You still need to determine whether it's a quality company with strong fundamentals.
- Stick to the Better Investing principles of investing in high-quality growth stocks.

Play the Long Game

- For long-term success, focus on owning high-quality growth stocks with:
- Solid, consistent sales growth and earnings growth rates,
- Stable or growing pretax profitability,
- Stable or growing return on equity, and
- Reasonable price-earnings ratios.

Beware of the Trade-Off

- Remember that the money used to pay a dividend isn't available for:
- Building new plants,
- Making new hires,
- Making other investments to grow the business.

It Doesn't Have to Be Either/ Or

- Some companies do balance both -- paying a dividend and maintaining good growth rates.
- Standard & Poor's has a Dividend Aristocrats list of companies that have increased dividends for at least 25 consecutive years.
- For the large companies making up the S&P 500, 5% is a sufficient rate for an investor in growth stocks.

The Price Is Right

- As with all stocks, follow the Better Investing principles and complete an SSG to make sure you're paying the right price.
- Paying too high a price, as measured by the P/E ratio, can damage your portfolio's overall total return.
- Despite the dividend payments, you can lose money when you sell the stock or earn a lower total return relative to other investments.

One Last Thing...

- Value a company as if it did not pay a dividend — after all, a dividend is just a capital-allocation decision made by management.
- Over the past 10+ years when interest rates were low some established companies borrowed to continue paying their dividends.
- This is unsustainable and not good management practice.

Resources

- This presentation is based on a series of articles by Adam Ritt and Vitaliy Katsenelson, CFA at:

<https://www.betterinvesting.org/learn-about-investing/investor-education/understand-dividends>