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Dive into dividend investing to get best long-term returns

By Jeff Benjamin March 21, 2010

The yield can make a big difference during slow economic times

Dividend investing is one of the best long-term investment opportunities out there, and it looks particularly alluring right now. “To just invest in growth stocks right now that don't pay a dividend, or don't pay a significant dividend, is no way to win at investing,” said Donald Schreiber, founder and chief executive of Wealth Builders Inc., which manages $400 million.

At this point, with only two weeks remaining in the first quarter, the comparison with the first three months of 2009 is a strong endorsement for the direction of dividend payments.

Between Jan. 1 and March 16, 72 of the S&P 500 companies increased or initiated dividends, while just one company decreased, and another suspended its dividend.

During the first quarter of 2009 — the worst period on record for dividend payouts — 55 companies increased their dividend payouts, and 40 decreased them. Six companies suspended their dividends during the period.

The year-over-year comparison has dividend-investing wonks jumping for joy, and the picture is even rosier in the context of a sluggish outlook for both the economy and the financial markets.

“It's a very good time for dividend investing,” said Howard Silverblatt, a senior index analyst at Standard Financial Services LLC.

Using history as a guide, he expects April to be a “major month for dividend increases.”

Some of the companies he expects to make positive dividend announcements include Exxon Mobil Corp. (XOM), International Business Machines Corp. (IBM), Johnson & Johnson (JNJ) and Procter & Gamble Co. (PG).

Together, those four companies represent 10% of the S&P's total dividend payout.

IBM is the only one of the four that isn't among the S&P 500 “dividend aristocrats” — a group of 43 companies that have increased their dividends for at least 25 consecutive years.

Based on current yield, which is the dividend payout divided by the stock price, the top five dividend payers among the aristocrats are AT&T Inc. (T) at 6.5%, Pfizer Inc. (PFE) at 4.2%, Chevron Corp. (CVX) at 3.7%, Johnson & Johnson at 3% and Exxon at 2.5%.

The case for dividend investing can be made in a variety of ways, including buying a stock ahead of a scheduled distribution, pocketing the dividend and selling shortly afterward.

But the real beauty of a dividend-investing strategy is the long-term effect that dividends can have on total return.

“Dividends can account for 60% to 70% of total return, and when you enter these slow economic periods, that dividend yield can make a big difference,” said Thomas Samuelson, chief investment officer of Advanced Equities Asset Management.

Over the past 10 years the S&P 500 had an annualized loss of 2.7% without including dividend payments, said Mr. Samuelson, whose firm manages $600 million.

With dividends, the annualized loss was pared down to 0.9%.

In addition to the contribution to total return, a dividend reinvestment approach can also act as an automatic dollar-cost-averaging strategy by forcing investors to buy shares regardless of market conditions.

“With dividends, you are forced to buy low, and that's something most investors never do,” Mr. Schreiber said. “How many retail investors do you think were buying stocks in March 2009 when it looked like the world was going to end?”

Mr. Schreiber drives home the dollar-cost-averaging point with the example of $10,000 invested in the S&P 500 in 1930 and held through 2009.

Appreciation alone would have turned the original investment into $490,000. But if all dividends were reinvested over the 79-year period, the original investment grows to $12.6 million.

The number of S&P 500 companies paying a dividend this year is 365, two ahead of last year but still down from 390 in 2007. In the stretch from 1980 to 1999, there were never fewer than 400 dividend payers in the index.

Historically, the United States has rarely been the first place that global money managers look to for dividend yields, but the trend toward increases is turning some heads.

“It's a very good time to start looking at dividends again, and we're now seeing some nice opportunities in the U.S.,” said Kris Hermie, manager of the $1.1 billion ING Global Equity Dividend and Premium Opportunity Fund (IGD).

Mr. Hermie, who manages the fund from The Hague, Netherlands, has a 36% weighting in U.S. stocks, making the United States and Europe the two largest allocations in the fund.

“A year and a half ago, I had a huge underweight in the United States,” he said.

Part of what gives Europe an edge over the United States in terms of dividend investing is that distributions are often paid out annually, while U.S. companies tend to pay quarterly.

The annual distributions make it easier for some portfolio managers to “buy the dividend” through a short-term investing strategy that is less appealing when dividends are paid quarterly.