Dividend Stocks Make a Comeback

La Presse - October 8, 2011
Stéphanie Grammond

Note: This article is an English translation from French of "La revanche des titre à dividend" from La Presse October 8, 2011, available at:
http://lapresseaffaires.cyberpresse.ca/finances-personnelles/plus-value/201110/07/01-4455277-la-revanche-des-titres-a-dividende.php

When the stock market heats up, wise investors adopt a defensive strategy and focus on solid companies that pay big dividends. But how do you find these companies? Three investment managers have selected stars for us in Canada, the United States, and Europe.

Last year, investors turned up their noses at high-dividend-paying stocks, says Kim Shannon, President, Sionna Investment Managers. "Investors were saying, 'A six percent return? That's it?' But today, things are different. Now, when investors see a six percent dividend, they are more likely to say, 'Wow, that's great!'."

According to Ms. Shannon, this is simply a matter of things returning to normal. With the market correction, high-dividend-paying stocks are finding favour with investors once again.

Over the long term, the shares of companies that pay dividends outperform those that do not (10.6% per year versus 2.2% per year). And companies that increase their dividend do even better (12.5%).

And yet, during the exceptional rebound that followed the credit crisis, we saw the exact opposite. Companies that made the effort to increase their dividend were left in the dust by companies that did not pay any dividends at all.

From February 2009 to June 2011, non-dividend-paying stocks increased by an explosive 53%, compared to an increase of only 27% for stocks with increasing dividends (+27%). The world had been turned upside down! Investors were sifting through the bargain bins. "Non-dividend-paying stocks over-performed over a very long period of time," Ms. Shannon explains.

Since mid-June, however, dividend-paying stocks have made a comeback, doing a much better job of riding out the fall in the stock market, and posting a mere 18% decline compared to the 48% freefall for non-dividend-paying stocks.

According to Ms. Shannon, shake-ups in the stock market aren't about to end. She thinks the market may continue wandering in the wilderness for another five years before finding its way and taking off again.

And she cautions: an on-again-off-again market is no time for heroics.

Her advice? Continue to exercise caution. Maintain a very-well diversified portfolio. Rebalance it constantly, selling winners and buying back losers. Focus on dividends, which may be the main source of performance if the markets don't take off again.

This is particularly true because bonds have never looked so unappealing. American ten-year bonds are paying a mere 1.8%; the S & P 500 Index Funds offer a 2.3% dividend. The gap in favour of dividends has rarely ever been so wide.

CANADA

Kim Shannon, President, Sionna Investment Managers, Picks Three Stars

BCE (BCE)

Dividend: 5.3%

Bell Canada Enterprises is probably the most widely-known brand in Canada. Its share is defensive, which is fitting for a public utility. However, with mobile phones, the telecommunications giant also offers the possibility of growth. No, Bell Mobility is not leading the wireless market, but it may expand by winning customers away from competitors, Rogers and Telus. Ms. Shannon also likes BCE's new management team and its focus on cost control.

Canadian Oil Sands (COS)

Dividend: 6.3%

According to Ms. Shannon, while the price of a barrel of oil is reasonable, the price of energy stocks is not. Prices that are this low are an indication that investors do not believe that oil will remain at this level, she explains. So why not take this opportunity to fill up? A high-quality stock, such as Canadian Oil Sands, which has good long-term reserves, is a good choice. Its dividend offers a very attractive return.

Great West Lifeco (GWO)

Dividend: 6.2%

These days, investors are very wary of insurance companies, whose shares are trading at below their historical value. They are also much less expensive than Canadian bank shares. Ms. Shannon feels that this is a good time to choose an insurer such as Great-West Lifeco, a solid, high-quality insurance firm that weathered the 2008 credit crisis well.

In the Penalty Box

Watch out for the former trust companies in the energy sector that had to convert back into corporations, warns Ms. Shannon. Several have continued to pay out at the same level and, for some, the well is running dry. Investors will need to do their homework, because some of these companies may reduce their dividends.

UNITED STATES

Nadim Rizk, Manager, Foreign Equity, Fiera Sceptre, Picks Three Stars

Johnson & Johnson (JNJ)

Dividend: 3.7%

Johnson & Johnson is "perfect for those who are looking for a high dividend and who want to sleep at night," says Nadim Rizk. J & J's activities are extremely well diversified in high-technology medical equipment, pharmaceuticals, and consumer products. Think baby shampoo. For the past five years, J & J has increased its dividend by an average of 8.6% per year, even during the recession in 2008.

Colgate-Palmolive (CL)
Dividend: 2.6%

Colgate-Palmolive's dividend is paying a little less. However, for the past five years, it has increased by 12% per year. "Absolutely extraordinary," says Mr. Rizk, who adds that a dividend that is increasing is better than a dividend that is already very high. When a dividend's performance exceeds 10% (e.g., a $1 dividend on a $10 stock), that's a bad sign. "This is often a sign that a company is in trouble. Before declaring bankruptcy, GM was paying over 10%," recalled Mr. Rizk. "When a company is not profitable, this kind of dividend is not tenable."

3M (MMM)
Dividend: 3.1%

3M made its mark with Post-It notes, but it has gone on to develop a host of other technologies, including the material used to produce tactile screens for digital tablets. 3M's shares are more cycle-sensitive. However, its dividend is rock-solid. In 2008-09, when 3M's profits fell from $4 billion to $3.2 billion US, its dividend was never in danger, because 3M always maintains an excellent margin for manoeuvre.

In the penalty box

Watch out for banks that do not have their own network of branches and that have to rely on public credit markets for financing, cautions Mr. Rizk.

EUROPE

Ian Scullion, Manager, Global Equity, CIBC, Picks Three Stars

Tesco (TSCDY)
Dividend: 3.9%

Tesco is a major player in the UK's food distribution industry—the UK's equivalent of Loblaw. However, this multinational corporation derives one-quarter of its profits overseas. It has a presence in 14 countries, including the United States, where it operates under the banner, Fresh & Easy. It also has operations in Eastern Europe and Asia, which are profitable markets. Tesco monitors its growth like clockwork, points out Mr. Scullion. In good years and bad, Tesco's sales have increased by 9% to 10%, which has enabled it to increase its dividend by 5% to 7%. For those who seeking generous returns, Tesco is a cash cow.

ABB (ABB)
Dividend: 3.5%

Swiss engineering giant ABB offers an attractive dividend and has a spectacular growth profile. But shouldn't investors be avoiding the industrial sector during a recession? "ABB is not as vulnerable to cycles as one might think", responds Mr. Scullion. "During the market downturn in 2008-09, it maintained respectably solid sales." That's because many of its projects are long-term power projects—a very lucrative sector, says Mr. Scullion, who adds that in the United States, the electricity grid is in shambles, leading to huge losses of energy. In addition, the developing nations have huge electrification needs...

Reed Elsevier (RUK)
Dividend: 4.5%

A competitor of Thomson Reuter, Reed Elsevier is a specialty publisher in the fields of science, medicine, and law. It publishes approximately 2,000 journals and reviews, including *The Lancet.* It pays a generous dividend, has no debt, and enjoys steady growth thanks to a loyal readership whose subscription renewal rate is close to 100% each year. In other words, the epitome of a stock that is not very cyclical.

In the penalty box

Even though their dividends offer a very high yield—upwards of 10% in many cases—beware of the European banks. If Greece declares bankruptcy, these banks may be adversely affected and their dividends may plummet.

Note: This article is an English translation from French of "La revanche des titre à dividend" from La Presse October 8, 2011, available at:
http://lapresseaffaires.cyberpresse.ca/finances-personnelles/plus-value/201110/07/01-4455277-la-revanche-des-titres-a-dividende.php