



Longview “INSIGHTS” Newsletter

“helping clients grow, protect and distribute their wealth”



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This is a report published by Five Star Wealth Manager* Keith Tufte of Longview Wealth Management, LLC with insights on investing and wealth management.

INVESTING QUOTE OF THE MONTH:

“If you are worried about sovereign credits, if you worry about U.S. Treasuries, there may be greater safety in equities, especially high dividend stocks.” – Larry Fink, CEO, Blackrock



INVESTING IN HIGH DIVIDEND STOCKS

“History shows that dividend paying stocks beat inflation and are good investments for income, especially in the early stages of a financial recovery such as we see today. The top 100 dividend-yielding stocks of the S&P500 index over the last half century beat the index by two and a half percent and did so with lower risk.” - Jeremy Siegel (financial expert and author of Stocks for the Long Run).



WHY INVEST IN HIGH DIVIDEND STOCKS?

We think high dividend stocks and funds are wise investments for many investors, particularly now. Corporations in America currently have record high cash levels. They can easily afford to pay current dividends, and it is logical to expect that they will continue to increase their dividends given strong earnings, cashflow, and balance sheets. Bloomberg estimates that dividends paid out by large corporations will increase by 15%-20% this year. Historically, dividends have provided approximately 40% of the total return of owning stocks.

ALTERNATIVE TO BONDS?

Many investors, especially older investors who are looking for income, are turning to high dividend stocks as an alternative to bond investments. This makes some sense given the very low bond yields that exist today. The current yield on the 10-year Treasury bond is only 3%. The current yield on a widely used total bond fund (based on the Barclays Aggregate Bond index) only yields 2.4%. There are many blue-chip stocks that currently have higher dividend yields than either of these bond benchmarks, such as GE, Proctor & Gamble, Pfizer, Johnson & Johnson, Intel, Pepsi, Merck, and Kraft. We like several low-cost diversified funds from Vanguard and WisdomTree that invest in high dividend stocks. These funds have dividend yields that are over 3% currently. We also like some publicly traded, energy master limited partnerships (MLP's) that have dividend yields of approximately 6%.

Another advantage to high dividend stocks relative to bond investments is lower taxes. The income tax rate on dividends is currently about half the tax rate you pay on interest income earned from bonds. Thus, even if the dividend yield on your stocks is the same as the yield you are getting on bonds, the after-tax yield (which is what really matters) is actually 33% higher on your stock dividends. This is true for taxable accounts but not IRAs or 401Ks obviously. The government could change the current low tax rates for dividends in the future, but current rates are very favorable.

Stock dividends also provide better growth and inflation protection than bond interest payments. When you buy a bond the interest payments are fixed for the life of the bond. They don't go up. Stock dividends tend to rise with corporate earnings over time, and historically have grown at above the inflation rate. If you buy a stock and a bond now with equal yields, and the dividend on the stock grows 4% per year, in five years your payout on the stock will be 21% higher than the payout on the bond. Your after-tax payout in five years will be 62% higher with the stock than the bond.

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High dividend stocks are typically a bit more conservative than stocks in general. The high dividend yield provides some cushion or downside protection for returns. High dividend stocks also typically have a value tilt to them, which we like since value stocks have outperformed growth stocks over time.

High dividend stocks are significantly riskier and more volatile than bonds. They are approximately three times more volatile than bonds (as measured by standard deviation). Because of this, we don't recommend investors shift much of their portfolio from bonds to high dividend stocks without also making other moves to dampen the risk of their portfolio. Doing so would significantly change (increase) the risk of their overall portfolio and it would likely not meet their original risk target. We think it makes sense to shift into high dividend stocks mostly from other risk assets such as equities. Small company stock valuations are currently at a 30-year high relative to large company stocks. We think shifting some money from small-cap stocks into large, high dividend stocks could make sense for many investors now.

DIVIDEND GROWTH FUNDS OR HIGH DIVIDEND FUNDS?

There are good arguments for both of these types of dividend paying stock funds. Should you buy stocks that already have high dividend yields, or those with lower current dividend payouts but with much higher expected dividend growth in the future? Funds that focus on stocks with high expected future dividend growth have yields of around 2%-2.2%, while high dividend yield funds typically have yields of 3%-3.5%. Which type of fund is best will depend on the income needs of each client. Companies that pay out a significant percentage of their earnings as dividends tend to have slower growth than companies that reinvest their earnings in their business. We do not recommend big allocations to high dividend stocks for those who are trying to maximize growth. We tend to prefer the funds that invest in stocks that already have the high dividend yields, especially for clients who are looking for income.

When buying individual stocks with high yields, investors must be careful. We don't recommend this for most investors. Individual stocks with dividend yields of over 5%-6% must be analyzed very carefully. Often these companies are risky and they may be about to cut their dividend, which can result in a stock price drop. The advantage of investing in high dividend funds or exchange traded funds (ETF's) is better diversification and risk management, and a more steady dividend stream.

INTERNATIONAL DIVIDEND STOCKS

We recommend significant international equity allocations for our clients. International (and emerging market) stocks currently have higher dividend yields than U.S. stocks. The international high dividend stock funds we like currently have dividend yields of 4%-5%.

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CONCLUSION

We think high dividend stocks and funds are a solid investment for the long run. We like high dividend funds that own blue-chip companies and are low-cost, diversified, tax efficient, and provide above average yields. We like funds that are diversified across industry sectors and don't get too concentrated in a few industries (such as utilities and telecom) that have high yields but lower expected growth rates.

Longview Wealth Management, LLC provides unique wealth management services for a select group of client families to give them peace of mind. Longview is run by Keith Tufte, who has over 23 years of successful investment management experience as a Wall Street Analyst, Mutual Fund Portfolio Manager, Director of Equity Research for a major mutual fund firm, Hedge Fund Portfolio Manager, and Wealth Management Advisor. Please FORWARD this e-mail to any friends/relatives/business associates that you think may have an interest. Please visit our website at www.longviewwealth.com.

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