

Avoid ulcers with ever-increasing Dividend Champions

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By Chris Taylor

Dec 7 (Reuters) – If there's one word to describe the stock market these days, its "manic". Up hundreds of points one day, down hundreds the next, spiking or collapsing based on whatever the latest rumor is of Europe. Many investors are aggravating their existing ulcers, or developing new ones, trying to keep up with it all. But Toronto's Nitin Pardal has another strategy: He couldn't care less.

The 26-year-old law-school grad is an unabashed follower of the Dividend Champions, a list of more than 100 stocks that have hiked their dividends for at least 25 years in a row. The stock market goes up, you get paid; market goes down, you get paid. Even better, if those dividends are consistently being boosted, you're virtually guaranteeing yourself a raise every year.

"It takes the fear out of the market," says Pardal, who holds dividend paying stalwarts like Johnson & Johnson and Abbott Labs in his portfolio. "When you buy a Dividend Champion, and you reinvest those payouts, it's the equivalent of compound interest in your bank account. You'll be far better off over the long-term, than if you tried to figure out the stock market every day."

Compiled by the DRiP Investing Resource Center ([http://www.dripinvesting.com](#)), the list of Dividend Champions includes such household names such as Clorox, Colgate, Palmolive, Target, Lowe's and Walgreen Co. In the same vein, the so-called Dividend Contenders have raised their dividends for between 10 and 24 years: Prominent names include General Dynamics, Imperial Oil, IBM and Nike.

Dividends are particularly attractive in an era of rock-bottom interest rates: For the first time since the 1950s, the average yield of stocks in the Dow Jones Industrial Average exceeds that of 10-year Treasury notes. Sure, they may not be the sexiest of investing approaches, having long been associated with seniors in need of an income system. But the proof of the tortoise-like strategy is in the numbers.

"An investment in the Champions group would have outperformed the S&P 500 by 5.1 percent over the last five years, and 5.9 percent over the last 10 years," says Joe Tatusko, chief investment officer of Connecticut-based money-managers Westport Resources.

Indeed, you can't deny the effect of dividends on portfolio appreciation. Looking at equities dating back to 1871, returns have amounted to 8.77 percent a year, according to research from Cambria Investment Management. But take out dividends and their reinvestment, and that number sinks to barely 4 percent. That means over half of total market returns are thanks to the humble dividend.

“We’re a quant shop at heart, but we’re open to whatever works, and dividends work,” says Mebane Faber, portfolio manager at Cambria and author of “The Ivy Portfolio.” “Companies that are raising or initiating dividends just do better than companies that are cutting or eliminating them.”

One easy way for dividend fans to invest in the strategy: The SPDR S&P Dividend ETF. It tracks the 50 highest-yielding stocks within the S&P 1500 Composite Index which have raised dividends for at least 25 years, and comes with a rock-bottom expense ratio of 0.35 percent. Year-to-date the ETF has returned 3.19 percent, beating the S&P 500 by almost three percentage points.

A couple of caveats, for those speculating in individual names: Having increased dividends for at least 25 years in a row doesn’t necessarily make for a robust yield. Oil-and-gas driller Helmerich & Payne qualifies for the Champions list, for instance, but only offers a paltry yield of 0.49 percent. A history of dividend hikes, while encouraging, is no absolute guarantee for the future; in brutal economic times, companies sometimes slice or eliminate dividends in order to shore up needed cash.

Bank of America was deleted from the Champions list when it cut its dividend after 30 years of increases, as was drug giant Pfizer, dropped after 41 years of hikes.

Also be aware that the most generous dividends can be a signal of turmoil, with embattled companies offering sky-high yields in order to keep investors on board. “When it comes to dividend yields, the top quartile of companies actually does worse than the next 25 percent,” says Faber. “Extremely high dividends tend to be riskier and unsustainable.”

As a result, winnow your potential Champions investments using a more holistic view of corporate financial health, says Faber. You don’t want firms that are borrowing too much cash to cover the dividend payout, for instance. You also want to see a company that pairs a steadily-increasing dividend with other shareholder-friendly pursuits like stock buybacks that are reducing the total number of shares outstanding.

If you’re concerned about diversification, stick to a fund like five-star-rated Vanguard Dividend Growth, which held a broad basket of 47 stocks at the time of its last report to shareholders.

As for Nitin Pardal, he’s a little befuddled why investing in the Dividend Champions has traditionally been the province of the Florida shuffleboard set. “Dividends are a great investing opportunity regardless of your age, but the benefits are actually greatest if you’re younger, says Pardal, who first caught on to dividends after reading “The Lazy Investor” by author Derek Foster. “It’s when you still have decades ahead, that dividend investing works to your best advantage.”

The author is a Reuters contributor. The opinions expressed are his own.