It's time to take a closer look at dividends

Dividends fuel market performance and deliver steady results over time *by Alison MacAlpine*

Many plan members are still skittish about investing in equities and, as a result, are holding disproportionate amounts of fixed income and cash in their portfolios. Dividend-paying stocks may be the way to encourage investors to participate in equity market returns again, and acquire sufficient growth in their plan to sustain their lifestyle in retirement.

Successful long-term investors have understood the potential of dividend-paying stocks for some time. Many see a company's ability to distribute dividends consistently, year after year, as an indicator that the business is well run. Others are reassured by the fact that dividend-paying stocks, as a class, tend to outperform other equities when markets are flat or sinking.

And while these investments tend to be perceived as relatively conservative equity vehicles, they pack a performance punch. It may surprise your plan members to learn that dividend income has, in fact, been the biggest driver of equity market returns. Over the past 50 years, capital appreciation has contributed just 40% to TSX performance. The compound return from reinvested dividends is responsible for 60% of those results.

As a consequence, the TSX Index (which tracks only capital appreciation) has grown by a factor of 11 over the past five decades—but the TSX Total Return Index (which combines capital appreciation, reinvested dividends and buybacks) has ballooned by a factor of more than 50 over the same time period (see chart).

Meanwhile, this strong performance has tended to come with lower volatility in recent periods. A research paper published by CIBC World Markets illustrated that dividend-paying stocks outperformed low dividend growth stocks during the full five years ended mid-2003, with much less variability in yearly results.[1]

ATTRACTIVE OUTLOOK

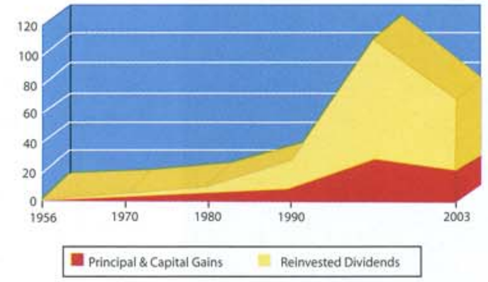
Yields from dividend-paying stocks are very attractive in today's market environment, with the average yield of the top 10 yielding equities on the TSX having overtaken yields for five-year Government of Canada bonds. The highest dividend yields tend to come from companies in the utilities, telecommunications services and financial sectors, while industries that are typically associated with growth—such as information technology and health care—tend not to provide significant dividends.

Looking ahead, the outlook for dividend-paying stocks appears positive. With corporate earnings momentum losing steam, stock valuations elevated around the world, and investors concerned about equity market volatility, it's likely that more and more investors will turn to the reliable returns of dividends. Rising interest rates in the United States and other countries may also be an impediment to stock market capital appreciation—leaving dividends to pick up an even greater share of equity performance.

Offering your plan members the opportunity to invest in dividend-paying stocks gives them access to a steady income stream, relatively stable returns during down markets, and the potential for capital appreciation. That may be just the incentive they need to move some of their fixed income and cash off the sidelines and participate once again in the growth possibilities of equities.

[1] *CIBC World Markets Occasional Report #43, July 23, 2003.*

RISING VALUE OF $1000 INVESTED IN TSX IN 1956



Source: CIBC World Markets & MFC Global Investment Management; data ended December 2003