

*Dividends' Desirability Grows  
As Availability Shrinks*

The second quarter's end brought good news – the Dow closed 11 percent higher than the end of the previous quarter – and two doses of reality: it remained down 3.8 percent for the year, and 40 percent from the all time high on October 7, 2007.

But whether you're a running bull or a clawing bear, both parties appear to agree on one point: the year's second half will need to be accompanied by a demonstration of a slowing of the economic decline for stocks are to continue in a rallying mode.

There is less consensus on whether those investors who rely on dividends to boost their returns will continue to succeed in that pursuit. The practice has fallen out of and back into favor. In the 1990s dividends were overlooked as investors chased tech stocks for dot com companies which not only offered no dividends, but often had no earnings to underpin the upward rise of their stocks. When the tech bubble burst companies which provided dividends had their stocks return to favor. In recent months investors have seen many companies' dividends evaporate overnight. But for the not-too-distant future, with the demographic pressure of the looming impact of Baby Boomers reaching retirement age, there is an expectation that the pursuit of dividends will rise again because of their predictability as a source of income.

There is one very compelling historic reason to look for dividend yielding investments: they have accounted for more than 40 percent of the market's returns and in the early part of this century grew more than 5 percentage points annually than non-dividend paying stocks. Countering that reasoning, though, is the increasing likelihood that the dividend tax rate will increase significantly from its current 15 percent level when the tax law sunsets at the end of 2010.

That hunt, though, isn't as simple as identifying those companies providing the highest dividend yields. *It isn't even as simple as identifying stocks with dividend yields.* Standard and Poor's recently reported that corporate dividends paid by companies in the S&P 500 rose 2.38 percent in 2008 – and that they expect dividends to decline by 22.61 percent in the current year. In fact, by early March the elimination of dividend income by companies had already surpassed all of those eliminated in the previous year, with 40 companies in the S & P announcing dividend eliminations, wiping out roughly \$40.8 billion per year in shareholder payouts.

Some of the dividend eliminations in 2008 were harbingers of things to come, like Washington Mutual, Wachovia, Bank of America, Citigroup, and Michigan's greatest source of dividends to investors, General Motors. Dividend investors would have done well to sell these investments upon the announcement of the end to dividends.

In the current environment, the return to investment fundamentals can't be over-emphasized. As has been reported repeatedly throughout recent months, corporations can make the decision to reduce or eliminate their dividend payments at any time. Another

Michigan-based company comes to mind as prime example: Dow Chemical, which announced in February a dividend cut for the first time in 100 years, when it reduced its dividends by 64 percent to improve the company's cash position.

The above is underscored by the examples of dividend cuts often being an action of last resort for companies in financial trouble.

Assess the environment. Last year financial stocks accounted for nearly 75 percent of the dividend cuts in the S & P 500. Although financial stocks enjoyed a good run in the last quarter, don't look to them for dividends. When Wells Fargo announced its dividend cut in March, the S & P 500's list of top 25 dividend payers no longer included any banks.

And if a dividend yield seems too high, it is – and for a good reason. High yields can reflect lowered stock prices, and more risk to the continuation of the dividend.

In the past dividend growth has been perceived as an indicator of a company's future, and dividend increases often helped stock prices because a higher payout could increase a stock's value. Investors can look to consistent dividend growth as one indicator of a company's quality – and a way to help boost investment returns. But investors should look further than that to determine whether a company is a solid choice.

At Norris, Perné & French our portfolio managers have five qualities that they seek before even considering a stock, dividend or no dividend. These are:

1. Does a company have earnings growth? What is the growth rate and for how long has it been sustained. Earnings growth compels price change.
2. Does the company have strong financial fundamentals?
3. Does the company's management have significant ownership in their organization? Is the management road-tested and proven over a range of business cycles?
4. Is there investor demand for the company's stock? Does the company enjoy positive market recognition?
5. And is the stock fairly valued given anticipated earnings growth?

When these fundamentals are in place, the addition of a dividend can be viewed as value added. Without the fundamentals the dividend can disappear in a quick decision by management.

*Julie M. Ridenour*  
*Director of Business Development,*  
*Norris, Perné & French, LLP*