Dividend Growth Investing: Realities, Myths, and Results

THE DIVIDEND GROWTH MACHINE

Dave Van Knapp
Audience Participation

Seeking Alpha

Daily Trade Alert

Top Stock Picks from Today's Leading Analysts
Tonight’s Topics

1. Remembering 2009
2. What Is Dividend Growth Investing?
3. Myths and Misconceptions
4. Typical Dividend Growth Stocks
5. Real Dividend Growth Portfolio

Q & A
1. Remembering 2009

Last time I talked to you
Paradigm Shift

Total Return = Price Changes + Dividends
Why Dividends? To Get...

• **Income** to meet expenses
• Income that *grows faster than inflation*
• **Away from trading** and market obsession

For me, DG investing *slows everything down*
2. WHAT IS DIVIDEND GROWTH INVESTING?

My own goals:

1. Generate a *steadily increasing* stream of dividends paid by *excellent, low-risk* companies

2. Deliver *10 percent yield on cost within 10 years* of inception

3. Be more interested in *ability to produce income* rather than sheer size of portfolio
Accumulation and Retirement

A. Ideal accumulation:
   — *Accumulate “dividend rights”* at good yields and valuations
   — *Companies increase their dividends*
   — *Reinvest dividends* to compound and accelerate dividend growth rate

B. Ideal endgame:
   — Retire on income *without needing to sell anything*
Virtuous Circle

Company Makes Growing Profits

You Buy More Shares

Sends Growing Dividends To You

Save, Spend, Whatever

THE DIVIDEND GROWTH MACHINE
Questions:
How many stocks traded on U.S. exchanges have grown their dividends *every year* for at least:

- 25 years?
- 10 years?
- 5 years?
Answers:
How many stocks traded on US exchanges have grown their dividends every year for at least:

- 25 years? 104
- 10 years? 207
- 5 years? 160

• Total = 471
• Longest streak: 60 years (Diebold)
How Do We Know This?

From the **DRiP Investing Resource Center.** Their “Dividend Champions” document is the gold standard:

- Updated monthly
- PDF or spreadsheet
- 80 pages of info
- Free
- Free!
### Dividend Champions, Contenders, and Challengers (CCC)

<table>
<thead>
<tr>
<th></th>
<th>Years Increased</th>
<th>Number</th>
<th>Average Yield</th>
<th>Average Most Recent Increase</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Champions</strong></td>
<td>25 +</td>
<td>104</td>
<td>2.6%</td>
<td>8.3%</td>
</tr>
<tr>
<td><strong>Contenders</strong></td>
<td>10-24</td>
<td>207</td>
<td>2.8%</td>
<td>8.8%</td>
</tr>
<tr>
<td><strong>Challengers</strong></td>
<td>5-9</td>
<td>160</td>
<td>3.3%</td>
<td>10.4%</td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td></td>
<td>471</td>
<td>2.9%</td>
<td>9.2%</td>
</tr>
</tbody>
</table>
Dividend Champions

• Streaks of 25 years +
• **Lowest** yielder: C.R. Bard (medical instruments)
  Yield = 0.78%. Years = 41.
• **Highest** yielder: Mercury General (insurance)
  Yield = 5.3%. Years = 26.
• I require **2.7%** minimum yield
  – **45/104** Champions have yields >= 2.7%
S&P 500 Not Good Proxy for DG Stocks

Source: Robert Shiller

Jun 23 2013, 2:36PM UTC. Powered by YCHARTS
This Is What We’re Talking About
Great Companies at Good Values

It is better to buy a great business at a fair price than a fair business at a great price.
Warren Buffett
Great Companies for DG Investing

- Pay dividends and raise them regularly
- Reliable business models
- Superior fundamentals
  - Plenty of cash to grow business and pay dividends too
  - Regular EPS growth
- Unbroken dividend-increase streaks
- Sufficient yield
What Is Stock Market’s Role?

• Dividends are largely independent from the market
• Market = Store

• Look for Mr. Market to offer sales on the stocks you want
  – Mr. Market will do that
Why Look for Stocks on Sale?

Stocks bought at better values confer benefits:

• Greater likelihood of *better long-term returns*
• *Higher yields*
• *Lower price risk*
  —Graham’s margin of safety
Morningstar Valuation

• Stars are a proxy for valuation

GREAT

FAIR

LOUSY
Audience Participation

F.A.S.T. graphs™
FASTgraphs Historical View

Black line = actual price

Green area = earnings

Orange line = “earnings justified” value

\[ P/E = 15 \]
FASTgraphs Projected View

Consensus analyst estimates for EPS growth

25 analysts 7.4% growth
3. **Myths and Misconceptions**

- **Myth #1:** Dividend growth investors don't care about total return
  - Total return is secondary consideration for most but primary consideration for some
  - Total return tends to be better anyway, according to most studies
More Myths

• Myth #2: Cash from "selling a few shares" is the same as dividends
  – Shares can only be sold once
  – Dividend shares keep on churning out cash

• Myth #3: Dividend growth investing = high-yield investing
  – “Sweet spot” often considered to be 3% - 5%
  – Many high-yielding equities are risky
Last One

• Myth #4: It takes bigger portfolio to live off income than by selling shares
  
  “4% rule”:
  
  • $1M portfolio $40,000

DG portfolio with 4% yield

• $1M portfolio $40,000

$40,000 = $40,000
4. TYPICAL DIVIDEND GROWTH STOCKS

Surveyed SA readers who identified themselves as “DG investors”

NOT SCIENTIFIC!!

Asked: What’s in your portfolio?

Tallied the results.
Typical DG Stocks

• Energy
  – Chevron
  – ExxonMobil
  – Kinder Morgan Energy Partners (MLP)

• Industrials
  – Air Products & Chemicals
  – Emerson Electric
  – Lockheed Martin
Typical DG Stocks

• Consumer Discretionary
  – Darden Restaurants
  – Hasbro
  – McDonald’s

• Consumer Staples
  – Altria
  – Coca-Cola
  – Procter & Gamble
Typical DG Stocks

• Healthcare
  – Abbott Labs
  – Johnson & Johnson
  – Medtronic

• Financial
  – Aflac
  – Realty Income (REIT)
  – Wells Fargo
Typical DG Stocks

• Information Technology
  – Intel
  – Microsoft
  – Paychex

• Telecommunications
  – AT&T
  – Verizon
  – Vodafone
5. **REAL DIVIDEND GROWTH PORTFOLIO (DGP)**

![Graph showing dividends received over years 2008 to Next 12, with an upward trend.]
<table>
<thead>
<tr>
<th></th>
<th>DGP</th>
<th>SPY</th>
</tr>
</thead>
<tbody>
<tr>
<td>Initial value</td>
<td>$46,783</td>
<td>$46,783</td>
</tr>
<tr>
<td>Current yield</td>
<td>3.9%</td>
<td>2.0%</td>
</tr>
<tr>
<td>Dividends 2013</td>
<td>$2491</td>
<td>$966*</td>
</tr>
<tr>
<td>Yield on cost</td>
<td>5.4%</td>
<td>2.1%</td>
</tr>
<tr>
<td>Current value</td>
<td>$67,864</td>
<td>$62,689</td>
</tr>
<tr>
<td>Total return**</td>
<td>+45%</td>
<td>+34%</td>
</tr>
<tr>
<td>CAGR of T.R.</td>
<td>7.7%</td>
<td>6.1%</td>
</tr>
</tbody>
</table>

* SPY cut distributions in 2009-2010
**With dividends reinvested
My Approach

• CCC
• Investment grade
• Minimum yield = 2.7%
  – Higher for utilities and MLPs
• Minimum DGR = 4%
• Accumulate dividends
  – Reinvest when >= $1000
  – Pick stock at Fair or better valuation
15 Stocks in the DGP
10 on Most Common List

- Alliant Energy (LNT)
- AT&T (T)
- BHP Billiton (BBL)
- Chevron (CVX)
- Darden Restaurants (DRI)
- Hasbro (HAS)
- Intel (INTC)
- Johnson & Johnson (JNJ)
- Kinder Morgan Energy Partners (KMP)
- Lorillard (LO)
- McDonald's (MCD)
- Omega Healthcare Investors (OHI)
- Realty Income (O)
- PepsiCo (PEP)
- Shaw Communications (SJR)
Thank you!!!

• Seeking Alpha: [www.SeekingAlpha.com](http://www.SeekingAlpha.com) (Free)
• DRiP Investing Resource Center: [www.DripInvesting.org](http://www.DripInvesting.org) (CCC is free)
• FASTgraphs: [www.Fastgraphs.net](http://www.Fastgraphs.net) (Free trials available)
Thank you!!!

- Ebook:
  - Complete DG Investing guide
  - Top 40 for 2013 and all prior years
  - FREE access to FASTgraphs for Top 40

- Available at my Website: www.SensibleStocks.com

Questions? Comments?