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Unwise Wisdom: Dividends Don't Count

By Cheryl Winokur Munk

After a decade-long bull market in stocks, dividends don't figure into many investors' plans.

Historically, slow-growth businesses such as banking, insurance, utilities and natural resources have used dividends as a lure to investors. The shares might not fly as high, the reasoning went, but every quarter you'll get a distribution of earnings to make it worth your while.

As the market got hotter, though, dividends lost their appeal. Standard & Poor's 500-stock index, one of the broadest barometers of the overall market, posted stunning annual increases of 37.6%, 23%, 33.4%, 28.6% and 21% in the five years from 1995 through 1999. Who could blame investors for shunning placid stocks that pay 3% to 4% a year, if that, in dividends?

"When I buy a stock, I don't even ask what the dividend is," says Scott Miller, a 42-year-old engineering manager in Elizabethtown, Pa. "If they pay something, great, but it's not in my decision-making process."

Mr. Miller isn't planning to change his focus, despite the recent rocky results most growth stocks have had. He says dividend rates would have rise to 7% to 8% to influence his stock selections.

And he isn't alone in his thinking. For the generation of investors that came of age in the 1990s, the watchword is growth. And a new breed of corporate officer is prepared to supply it, dumping dividends in favor of value-enhancing moves such as stock buybacks. From 1973 through 1977, 33% of the companies that went public paid dividends. By 1999, only 3.7% of new publicly traded companies paid dividends, according to a study by Eugene Fama, a professor of finance at the University of Chicago Graduate School of Business, and Kenneth French, a professor of finance at the Massachusetts Institute of Technology's Sloan School of Management.

But, some investment professionals warn, investors need to take another look at the seemingly stodgy dividend. With the market struggling – the S&P 500 lost 10.1% in 2000, its first negative return since 1990; the Nasdaq market, the haven for growth stocks, lost 39.3% last year – and economic growth slowing, investors will need a way to make up the lost returns. And dividends could help strengthen a portfolio hobbled by a sinking market, they argue.

"In a market that is less robust, a 4% or 5% dividend yield is meaningful," says Brian McCarthy, a broker for Tucker Anthony Inc. in Boston.

"Dividends are certainly more alive today than they were a year and a half ago," adds Eileen Dorsey, a certified financial planner in St. Louis. Kathleen Fuller, an assistant professor of finance at the University of Georgia's Terry College of Business in Athens, studied the performance of dividend-paying stocks from 1970 to 1999. She says the research, conducted with Michael Goldstein, a professor of finance at Babson College in Wellesley, Mass., shows that dividend-paying stocks underperform when the market is booming, but they make up for it during down times.

"In a down market, dividend-paying firms do better than non-dividend-paying firms, and that will make them more attractive at least to some investors," says Ms. Fuller.

Dividend-paying stocks, the pros say, make particular sense for older investors, who need a steady, reliable stream of income. "You start putting a premium on predictability," says Guy Cumbie, a certified financial planner in Fort Worth, Texas.

Scott Kahan, president of Financial Asset Management Corp., a financial-planning firm in New York, expects some older clients who had ignored dividend-paying stocks to start warming to them. "As the market continues to have shakeouts, older people especially will get more concerned, and many will go back to where they should be," he says.

Joyce McKee's attitude certainly has changed. "Dividends had no meaning when you were making tremendous gains in the market," says Ms. McKee, 71, a former interior designer in Washington. She was an active trader until June, but now says she is buying dividend-paying stocks to hold until the market rebounds.

Even some younger investors are changing their view of dividends. Vivian Chang, a 26-year-old architect in Tyson's Corner, Va., says dividends are the deciding factor when she is deciding which of two comparable stocks to buy. "If one of them has a dividend, I'm going to pick that," she says.

Stocks that pay dividends seem safer, she says, even when their prices are declining. "For me, it's peace of mind knowing I have income coming in and it's not all loss," she says.

Ms. Chang has been investing since she was a junior in college and has been watching the stock market closely since she inherited some stocks from her mother. About 30% of Ms. Chang's portfolio is in technology stocks, many of which pay dividends -- such as Intel Corp., Adobe Systems Inc. and International Business Machines Corp. Some of her other stocks include Citigroup Inc., American Express Co., First Union Corp. and PNC Financial Services Group Inc.

(Dana Corp. had the highest dividend yield among S&P 500 companies, 8.1%, last year, according to Reuters Group PLC's Instinet Corp. Dividend yield is determined by dividing annual dividends per share by the current market price. Philip Morris Cos. led the Dow Jones Industrial Average in dividend yield last year, at 4.8%.)

Still, many investors will take more convincing. Ms. McKee's 38-year-old stepson, Andrew McKee, of Boston, remains invested in growth stocks. "I don't want to pay higher income taxes," says Mr. McKee, who recently sold a network of travel agencies he founded.

It would take much higher dividend rates to win him over, he adds. "Why would I do it for a dividend that is only 1%?" he asks. "I could put my money in a savings account."

Eddie Sawyers, president of Pilot Rack Co. in Mount Airy, N.C., says that even in a lengthy down market, he probably would invest in certificates of deposit, bonds and government-backed securities rather than dividend-paying stocks.

"Dividends are historically not a huge percentage of your investment," says Mr. Sawyers, 35. Consider a \$50 stock paying \$2.25 a year in dividends; if the stock price falls \$5, the investor still has a net loss of \$2.75, he says. "You'd be better off to put that money in a CD."

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