

What is a Dividend?

Dividends increase your total wealth

A cash dividend is a dollar amount paid to the shareholder of a stock. Each share that you own qualifies to receive a dividend. For example, if you own one hundred shares and the annual dividend is \$2 per share, you will receive a \$200 each year. So the more shares that you own the more dividends you will receive. Most dividends are paid every quarter (three months) but occasionally a company will pay a special one-time dividend.

A stock that pays a cash dividend is a real asset to the long-term investor. The cash that you receive is actual money in your pocket. You can spend it, save it, buy a new investment or reinvest it in a stock that you already own. Unlike stocks prices that go up and down and create uncertainty and angst for investors, reliable dividends are unaffected by fluctuations in stock prices.

Many successful companies have long histories of paying dividends year after year and many of

What is Dividend Reinvestment?

Accumulate more shares at no added cost

Dividend reinvestment is a systematic method of accumulating shares of a stock that pays a dividend. Many investors use dividend reinvestment as part of a long-term buy-and-hold investment program. After you purchase a stock, simply enroll in the company's dividend reinvestment plan (DRIP) and your dividends will be automatically used to purchase additional shares. Also, you may send voluntary contributions to purchase additional shares. For a mutual fund be sure to check off the dividend reinvestment option on your application form.

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these companies regularly increase their dividends. Dividends keep coming during good and bad times as long as the company remains financially healthy. Therefore, an investment portfolio that includes a large proportion of high quality dividend-paying stocks provides an uninterrupted cash flow.

"Dividends are cash in your pocket"

Here's a real example of how dividend reinvestment works. In 1987 I opened an Individual Retirement Account (IRA) and bought the Vanguard 500 Index Fund (VFINX), which is a low-fee index fund that tracks the S&P 500.

I invested \$1,513 in eight purchases and bought 58.979 shares. On December 28, 2005 I owned 89.345 shares because of reinvested dividends. The account was worth \$10,347.94. Without the reinvested dividends the account would have been worth \$6,830.95.

Own Stocks with Sound

Dividends

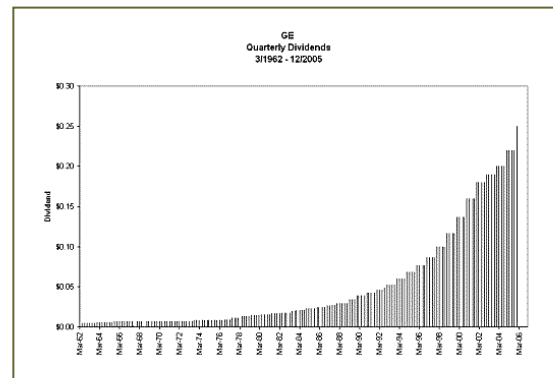
Dividends provide income or more shares

Buy and hold dividend-paying stocks and funds that hold stocks with long records of paying increasing dividends. To start buy the iShares Dow Jones Select Dividend Index (DVY), an exchange-traded fund (ETF) that holds 100 dividend-paying stocks. DVY tracks the Dow Jones Select Dividend Index. Another good choice is the SPDR Dividend ETF. SDY tracks the Standard & Poor's High Yield Dividend Aristocrats Index, which includes 50 high-yield stocks that have raised dividends for at least 25 consecutive years. Owning these low-fee ETFs ensure that you have a well diversified portfolio of high quality dividend-paying stocks.

If you're looking for companies with solid long-term financial performance and reliable increasing dividends, check out the Mergent's Dividend Achievers, with over 300 companies that have increased cash dividend annually for at least the last 10 consecutive years. Achievers include well-known names like: Exxon Mobil (XOM), General Electric (GE), Heinz (HNZ), Home Depot (HD), Illinois Tool Works (ITW), McDonald's (MCD), Pfizer (PFE), PepsiCo (PEP), Tootsie Roll (TR), and Wrigley's (WWY). PowerShares Capital Management LLC offers four exchange-traded funds (ETFs) based on the stocks that comprise the Mergents Dividend Achievers.

Standard and Poor's maintains three lists of companies that have a history of consistently raising dividends: S&P 500 Dividend Aristocrats, S&P High Yield Dividend Aristocrats and S&P Europe 350 Dividend Aristocrats. Some of the companies are: Johnson & Johnson (JNJ), Johnson Controls (JCI), General Electric (GE), 3M (MMM), Emerson Electric (EMR), Tootsie Roll (TR), Northwest Natural Gas (NWN), and Piedmont Natural Gas (PNY).

*Dividends paid by General Electric: 1962 – 2006.
Notice how they have increased.*



Electric and natural gas utilities are excellent dividend-paying stocks because of their generous free cash flow. Ameren (AEE), Keyspan (KSE), Progress Energy (PGN), Southern (SO), WGL holdings (WGL) are excellent candidates for a dividend reinvestment portfolio.

Real Estate Investment Trusts (REITs) that own commercial and residential properties pay high dividends but their dividends fluctuate depending on the real estate market.

Regional banks pay reliable dividends and many of them regularly increase their dividend. Forestry and paper stocks are good bets for reliable dividends.

Dozens of managed mutual specialize in dividend-paying stocks funds, but avoid them because most funds charge high fees which will substantially reduce your returns.

“Solid companies pay a steady stream of dividends to their shareholders.”

Important Dividend Terms

Understand yield, payout ratio and key dates

The *dividend yield* is the ratio of the annual dividend amount to the current price of the stock. So if the dividend is \$1 and the current price is \$50, the yield is 2% ($\$1 / \50). But when the stock changes price the current dividend changes accordingly. So if the stock moves up to \$55, the dividend yield drops to 1.82%. Or if the stock price falls to \$45, the dividend yield increases to 2.22%. Beware of dividend yields that are historically high for a stock. Unusually high yields can occur because the price of the stock has been beaten down signaling problems with the company so the dividend could be reduced or eliminated.

Once you buy a stock, do not use the day-to-day price to compute your dividend yield. Rather use your purchase price to compute the yield. Your dividend yield becomes the ratio of the dividend dollar amount to the dollar amount that you paid for the stock.

The *payout ratio* is the annual dividend divided by the annual earnings. If the ratio is greater than 80% to 90%, the current dividend might not be sustainable. Some payout ratios are greater than 100% and these dividends are very suspect. Always check the payout ratio before you buy a dividend-paying stock.

To ensure that you receive the dividends that are due you, understand the *key dates* related to the declaration and payment of dividends.

Announcement (Declaration) Date is the date on which the board of directors of a company

“Dividend yield tells you what you will earn from your dividends”

announces the amount of the next dividend and its ex-dividend, record and payment dates.

Ex-Dividend Date is the date on which or after the stock trades without a dividend. So if you buy the stock on or after the ex-dividend date, you will not receive the next dividend. If you sell a stock before the ex-dividend date, you will not receive the dividend (the buyer will receive the dividend). If you sell after the ex-dividend date, you will receive the dividend (the buyer will not receive the dividend).

Record Date is the date the company determines the list of shareholders who qualify for the dividend. To be a shareholder of record you must own the stock at least one day before the ex-dividend date.

Payment Date is the date on which the dividend is paid to shareholders of record in the form of a dividend check or a credit to your account.

For example, General Electric (GE) declared its regular quarterly dividend of \$0.25 on November 11, 2005. The ex-dividend date is December 22, 2005, the record date is December 27, 2005 and the payable date is January 25, 2006.

The dividend payback period is the time that it takes to recover your initial investment just from the accumulation of dividend payments. For example, if you bought a stock for \$20 and it paid a constant annual dividend of \$1, the payback period is 20 years. This simple procedure does not take inflation into account and assumes the dividend remains constant. The larger the dividend the shorter the payback period for stocks with the same purchase price. Some investors use the payback period to help them select dividend-paying stocks.

A Starter Dividend Portfolio

Getting started with ten dividend-paying stocks

Here are ten stocks that pay reliable dividends. The portfolio includes two stocks in each of five market sectors. Use this portfolio to start your dividend-reinvestment program.

Starter Portfolio			
Company	Symbol	Industry	Dividend and Yield
General Electric	GE	Conglomerate	\$1.00 (2.80%)
3M Company	MMM	Conglomerate	\$ 1.68 (2.10%)
Southern Company	SO	Electric Utility	\$ 1.49 (4.30%)
Duke Energy	DUK	Electric Utility	\$ 1.24 (4.60%)
Procter & Gamble	PG	Consumer Products	\$ 1.12 (1.90%)
Clorox	CLX	Consumer Products	\$ 1.16 (2.10%)
ConAgra Foods	CAG	Food Processing	\$ 1.09 (5.10%)
Hershey Foods	HSY	Food Processing	\$ 0.98 (1.80%)
Duke Realty	DRE	Real Estate Operations	\$ 1.88 (5.50%)
New Plan Excel Realty	NXL	Real Estate Operations	\$ 1.25 (5.20%)

Dividend and yield data are from finance.yahoo.com as of December 3, 2005.

Summary

Dividends are real cash that you can treat as income or reinvest to accumulate shares. Buy stocks that pay reliable, increasing dividends or buy low-cost exchange traded and index funds that specialized in dividend-paying stocks.

About the Author

Richard Howard maintains *buyupside.com*, a free site for individual investors. He has written numerous articles about investing and is the co-author of *Buy on the Upside*, a book which discusses the principles of investing. It is available from major Internet book sellers.

“A portfolio of dividend-paying stocks will grow in value with time.”

More Information

For more information about investing see *buyupside.com* and other *buyupside.com* investing guides:

- *Beginner's Guide to Investing in Stocks*
- *Beginner's Guide for Young Investors*
- *Beginner's Guide to Index Funds and Exchange-Traded Funds*
- *Beginner's Guide to Retirement investing*