

## Investing for dividends

When an investor purchases stock, he or she stands to gain in two ways. First, the investor may sell the shares after they have appreciated in value. Second, earnings may be distributed to shareowners in the form of dividends.

Of course, dividend payments are not guaranteed. For instance, companies on a growth track may choose not to pay dividends but, instead, reinvest their earnings in the company. During economic downturns, dividends may be cut or omitted.

### ***Mixed results for dividends in 2007***

Standard & Poor's (S&P) reports that the number of companies that increased their dividends in 2007 fell slightly from 2006. Of approximately 7,000 publicly owned companies that reported dividend information to S&P, 1,857 increased their dividends, down from 1,969 in 2006. Still, that's surprising strength in dividend growth given the weakness in 2007 in the financial sector.

Howard Silverblatt, a senior index analyst at S&P, attributes the small decline in dividend increases to a current trend of "favoring stock buybacks at the expense of committing to long-term cash dividends." (Unlike dividends, where a company permanently parts with its earnings, buybacks allow companies to maintain ownership in the shares and to reissue them sometime in the future.)

Negative steps by companies such as dividend decreases and suspensions, he notes, might be attributable to rising concern over difficulties in the financial and consumer discretionary sectors.

On the flip side, companies in the S&P 500 paid a record \$27.73 a share in dividends in 2007, an amount that Standard & Poor's expects to rise 9.3% in 2008. Dividends for companies in the S&P 500-stock index grew by 11.5% in 2007 compared to 2006.\*

The S&P data also reveal that corporate buybacks have outpaced dividends in aggregate dollars and growth.

### ***When should an investor consider dividend-paying stocks?***

Dividend-paying shares generally find favor in a falling market, because the dividend may provide a cushion against price declines. When stock prices drop, dividend yields (the annual dividend payment divided by the stock's price per share) increases because the investor pays less to buy the same stream of dividend payouts. For example, if XYZ Stock is trading at \$50 a share and pays \$2.00 a share in dividends, the dividend yield is 4.0%. But if the stock drops to \$40 per share, the dividend yield rises to 5.0%.

Also, dividends are attractive because of the currently favorable tax rates on them. Most dividends are taxed at a maximum rate of 15%. (Taxpayers in the 10% and 15% brackets pay no tax at all.) Compare that to an investor with taxable bond income who is in the 35% tax bracket. He or she nets \$65 from \$100 in taxable bond income, but \$85 from \$100 in dividend income. However, the lower tax rates are temporary. (See the table below.)

### ***End of an era?***

Lower taxes on long-term capital gains, dividends and ordinary income, in place since 2003, may come to end in less than three years. If they do end, tax rates will jump to pre-2001 levels (long-term capital gains rates to pre-2003 levels).

	<i>Qualified dividend tax rates</i>	<i>Long-term capital gains tax rates**</i>	<i>Ordinary income tax rates</i>
2008-2010	For taxpayers in the 10% and 15% brackets, 0%; all others, 15%.	For taxpayers in the 10% and 15% brackets, 0%; all others, 15%.	10%, 15%, 25%, 28%, 33% and 35%
2011	For taxpayers in the 15% brackets, 10%; all others, 20%.	For taxpayers in the 15% brackets, 10%; all others, 20%.	15%, 28%, 31%, 36% and 39.6%

### **Look out for the pitfalls**

Whether an investor can reap better rewards by putting a focus on companies that pay regular dividends depends, of course, on whether or not the companies continue paying dividends at high levels. When an investor buys shares in a company that has an inflated current yield relative to its historical average yield, and then the company fails to follow through with those dividends in the future, share prices will suffer as well.

Further, a high dividend yield could be an indicator of a company's poor health. Questions to ask: Is the company in a strong cash position going forward, sufficient to continue paying dividends at current or higher yields? Does the company have a consistent history of earnings and earnings growth? Has the company recently taken on a large debt, and, if so, how will that debt be paid?

Picking the right companies isn't a job for the amateur investor. The guidance of an experienced and knowledgeable investment professional will be helpful. That's why we're here. If you are interested in finding out more about investing with an eye toward dividends, or any other investment issue, please contact us at any time.

\* The S&P 500 is an unmanaged index composed of 500 widely held securities considered to be representative of the U.S. stock market in general. Investors can not invest directly in any index. Past performance does not guarantee future results.

\*\* Certain assets (proceeds from the sale of real estate with uncaptured depreciation, collectibles and certain small business stock) are taxed at higher rates.

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