Spotlight

The Power of Dividends

> *"Do you know the only thing that gives me pleasure? It's to see my dividends coming in,"*
>
> – John D. Rockefeller

It was likely the regular 'paycheque' dividend-paying stocks provide that was the source of pleasure for this American tycoon and industrialist – and can be for investors.

This Spotlight will highlight the advantages of dividend-paying stocks and why investors should consider them to help them meet their long-term financial goals.

Dividend basics

Broadly speaking, a company can do one of two things with its earnings – reinvest them back into the business or pay a portion of them to shareholders in the form of dividends (share buybacks are a third option, which we won't discuss). Typically, start-up companies, or those in growth mode, take the former route to help boost expansion. Mature, more established companies tend to opt for the latter to help maximize shareholder growth. A dividend is a distribution of a portion of a company's earnings, typically paid on a quarterly basis to shareholders.

The case for dividend investing – considering the big picture

For investors trying to earn a return on their investment, capital gains are one consideration – but only one. The total return of a security includes capital gains as well as interest and dividends.

If you are investing for the long term, the dividend component of a stock's total return can become a very important consideration. In the *Triumph of the Optimist: 101 Years of Investment Returns**, the authors write "The longer the investment horizon, the more important is dividend income. For the seriously long-term investor the value of a portfolio corresponds closely to the present value of dividends."

Advantages of dividend-paying stocks

More important than how dividends work is why they matter. The key benefits to dividend investing are:

Downside Protection

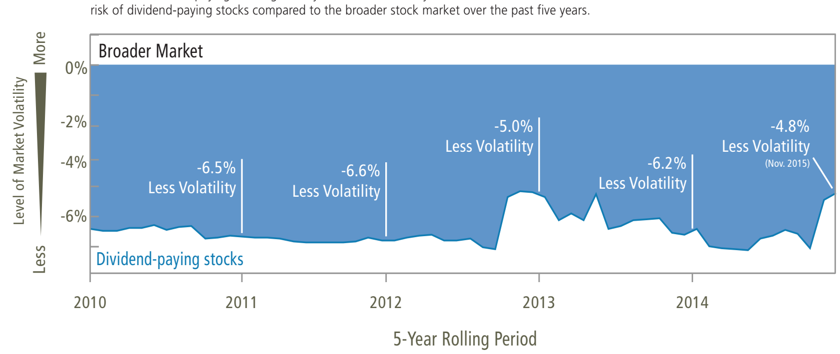
The steady cash flow dividends provide tends to dampen overall volatility of dividend-paying stocks compared to the boarder market, as the following visual illustrates. While stock prices can fluctuate considerably, the dividend tends to be relatively stable, as the company management is typically committed to maintaining or increasing per-share dividend rates over time. Even in recessionary times, dividend cuts tend to be relatively rare.

Flexibility

Investors in dividend-paying stocks have the option to receive regular cash flow or re-invest those dividends into additional shares. Re-investing dividends allows investors to continue to grow their capital (and associated

Difference in Risk (Dividend-paying Stocks vs. the Stock Market)

Canadian dividend-paying stocks generally exhibit less volatility than the broader Canadian stock market. The chart illustrates the reduced risk of dividend-paying stocks compared to the broader stock market over the past five years.



*Triumph of the Optimists: 101 Years of Global Investment Returns. Dimson, et al. 2002.

Source: Morningstar. Based on 5 year rolling annualized standard deviation from January 1, 2006 to November 30, 2015. Standard deviation is a measure of volatility, which is an indication of risk. Level of volatility indicates the differential between the S&P/TSX Composite Dividend Total Return Index (as Canadian dividend-paying stocks) standard deviation and the S&P/TSX Composite Total Return Index (as broader Canadian stock market) standard deviation, expressed as a percentage.

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cash flow) while reaping the benefits of compound growth.

Good Corporate Governance

Dividends force a company's management team to be disciplined. Once a company begins to pay a regular dividend to shareholders, it is rare and unlikely that it will stop paying it. Furthermore, since dividend payments are required to be disclosed on the company's income and cash flow statements, management is typically unwilling to make the payment unless they have sufficient earnings to fund the dividend. Dividend payments represent a distribution of corporate earnings to shareholders and are a sign of corporate stability. A company must have a certain level of financial health before management would elect to pay out profits rather than re-invest in the business.

Balancing Income with Growth

Most dividend-paying stocks, unlike some of their income-paying counterparts, tend to see share price appreciation over time, which provides the investor with a capital gain in addition to the regular cash flow that they receive in the form of the dividend. Dividend paying stocks also provide a degree of protection against inflation, as they tend to increase their dividends over time.

As one approaches retirement, investment goals often shift from growth to the relative stability and regularity of income. In order to accommodate this shift, many investors will increase their portfolios' allocation to bonds, but in some cases dividend-paying stocks are an additional option to consider, particularly with interest rates at historic lows. Canadians are living longer than ever, so the need to balance income with modest growth is becoming increasingly necessary to adequately fund their retirement years.

Not all dividend stocks are created equal

Not all dividend-paying stocks are created equal, and weighing their merits can be confusing for do-it-yourself investors. Savvy stock selection of best-in-class businesses with quality management teams is key, as is paying a reasonable price. While it may seem intuitive to purchase stocks with the highest dividend yield, a wiser approach can be selecting those that consistently grow dividends over time, which can positively impact total returns over the long term.

Final thoughts

During volatile markets, and while interest rates remain low, understanding – and leveraging – the power of dividends can help you reach your long-term financial goals. There are many options and solutions available for investors – from the long-standing Scotia Canadian Dividend Fund or Series T portfolios (to receive regular income payments) - your financial advisor can help you find the investing solution that works for you. ■

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