

Financial Jungle

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High Yielding Dividend Stocks Flexing Muscles

- Posted by [Financial Jungle Guy](#)
- April 10, 2008

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The [Dividend Guy](#) recently touched on a research paper that revealed a surprising result about dividend investing; stocks that generously distribute larger percentages of their earnings to shareholders tend to outperform their stingy counterparts. This is counter-intuitive considering that the more earnings a company distributes to shareholders, the less retained earnings remain to grow the business. For more on this finding, download **Does Dividend Policy Foretell Earnings Growth?** from [Papers.SSRN.com](#).

As if that wasn't a head-scratcher, renowned value-investing firm, Tweedy Browne, compiled a series of [studies](#) suggesting another firmly held conventional wisdom is about to come crumbling down. It's widely believed that one law of dividend investing is to buy lower yielding stocks if you want to accelerate portfolio growth. Beware of such assumption as the paper begins eloquently with a quote from T.H. Huxley.



The deepest sin against the human mind is to believe things without evidence.

As far as I'm aware, this is the very first time that someone gathers not one, not two, not three, but twelve independent research studies using empirical evidence to reinforce the claim that the highest yielding stocks trash their low-yielding counterparts consistently over a variety of periods and geographies.

Here are some quotes from each research:

1. **Triumph of the Optimists: 101 Years of Global Investment Returns (2002)** - Over 101 years, [Elroy Dimson, Paul Marsh, and Mike Staunton] found that a market-oriented portfolio which included reinvested dividends would have generated nearly 85 times the wealth generated by the same portfolio relying solely on capital gains. (1900 to 2000, US & UK.)
2. **Dividends and the Three Dwarfs** - [Robert D. Arnott] concluded that dividends were far and away the main source of the real return one would expect from stocks, dwarfing the other constituents: inflation, rising valuations, and growth in dividends. (1802 to 2002, S&P500.)
3. **Taxes, Dividend Yields and Returns in the UK Equity Market** - Using data from the London Share Price Database (LSPD), [Gareth Morgan and Stephen Thomas] examined the relationship between dividend yields and stock returns from 1975 through 1993 in the UK. Database companies were ranked by dividend yield at the end of each month and divided into six groups, including a zero dividend group (companies that did not pay dividends). ... they find a strong [positive] correlation between the size of the dividend yield and the average monthly return. (1975-1993, UK.)
4. **Market Anomalies: A Mirage or a Bona Fide Way to Enhance Returns?** - Using a sample of 4,413 companies which were

listed on the London Stock Exchange during January 1955 through December 1988, Lenhoff ranked all listed companies each year according to dividend yield and sorted the companies into deciles. ...there was almost a perfect correlation in the decile returns between higher dividend yields and higher annualized returns. The top decile, in terms of high yield, produced an average annualized return over 34 years of 19.3% versus 13.0% for the Financial Times Actuaries All Share Index. (1965 - 1998, UK.)

5. **The Importance of Dividend Yields in Country Selection** - Michael Keppler examined the relationship between dividend yield and investment returns for companies throughout the world. ... The study indicated that the most profitable strategy was investment in the highest yield quartile. The compound annual investment return for the countries with the highest yielding stocks was 18.49% in local currencies (and 19.08% in U.S. dollars) over the 20-year period, December 31, 1969 through December 31, 1989. The least profitable strategy was investment in the lowest yield quartile, which produced a 5.74% compound annual return in local currency (and 10.31% in U.S. dollars). (1969-1989, world.)
6. **Dogs of the Dow** - [Michael O'Higgins] discovered that by investing in the 10 highest yielding securities in the Dow Jones Industrial Average of 30 industrial companies, and rebalancing annually, one could substantially outperform the average itself. (1973-1998, Dow Jones Industrial Average.)
7. **Triumph of the Optimists: 101 Years of Global Investment Returns** - Higher dividend yield stocks outperformed their lower-yielding counterparts and the index by 180 and 160 basis points annualized from year end 1926 to year end 2000 (a basis point is one-hundredth of a percentage point). This translated into 2.29 times the wealth generated by the lower-yielding stocks. (1926-2000, US.)
8. **The Future for Investors** - In Jeremy Siegel's study, on December 31 of each year, the S&P 500 stocks were sorted into five quintiles ranked by dividend yield. He then calculated the returns of the stocks and quintiles over the next year, re-sorting at year-end. He found that better results were directly correlated with higher dividend yields. The highest yielding quintile (top 20% of S&P 500 based on yield) produced an annualized return of 14.27% versus an annualized return of 11.18% for the S&P 500 Index, which resulted in three times the wealth accumulation of the index. (1957-2002, S&P 500.)
9. **Contrarian Investment Strategies: The Next Generation** - David Dreman analyzed the annual returns of price-to-dividend strategies using data derived from the Compustat 1500 (largest 1500 publicly traded companies) for the 27-year period ending December 31, 1996. As indicated in the table below, he found that the highest yielding top two quintiles of the Compustat 1500 stock universe — as reflected by low prices in relation to dividends — outperformed the market by 1.2% and 2.6% annualized, respectively, and outperformed the stocks with low-to-no yield by 3.9% and 5.3% annually. (1970-1996, US.)
10. **Lehman Brothers Equity Research** - High dividend yield stocks were found to have produced more return with less risk than their low-yield counterparts. The Lehman analysts studied the one thousand largest of U.S. firms ranked by market capitalization, and rebalanced these securities quarterly, starting in January 1970. They found that the top-yielding quintile produced a 13.7% equal-weighted total return per year with a 15.5% standard deviation of return. The bottom-yielding quintile, in comparison, returned 9.0% with a 29.1% standard deviation. (1970-2006, US.)
11. **High Yield, Low Payout** - Over the 26-year period, [Credit Suisse Quantitative Equity Research] found that stocks with higher dividend yields generally outperformed those with low dividend yields, but the highest yield decile did not produce the best overall return. As their chart indicates, deciles 8 and 9 outperformed decile 10, the highest yield decile. ... However, the best returns have not come from those with the highest yields — higher yields coupled with low payout ratios have produced the best returns. (1980-2006, S&P 500.)
12. **When The Bear Grows: Bear Market Returns** - The Compustat 1500 database (1500 largest publicly traded stocks) was used, and the performance of four value strategies — low price-to-earnings, low price-to-book value, low price-to-cash flow, and high dividend yields — were measured and averaged for all down quarters and then compared to the index itself for the 27-year period. All of the value strategies outperformed the market, with the high dividend strategy (low price-to-dividend) performing the

best of all the value strategies, declining on average only 3.8%, or roughly half as much as the market. (1970-1996, US.)

Note that the yield is only one facet of a sound stock selection process. Although the typical high-yielding stocks have overwhelming astounded investors with superb total performance, others have slashed or halted their juicy yields due to unsustainable dividend policies.

Just to be on the safe side, we should also examine other financial figures abreast including, but not limited to the price-to-earning (P/E) ratio, free cash flow, payout ratio, debt-to-equity (D/E), return on invested capital (ROIC), revenue growth, and earning growth. One of my favourite sites to look up financial numbers is MSN Finance. Here's an example link to [Saputo's historical cash flow statements](#).

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100 Trades, 92 Wins

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Reader Comments

1

Written by: [Dividends4Life](#)

Posted on: April 10, 2008 at 1:32 pm

Great read! I rely on running the numbers with no pre-conceived notion based on yield or payout. Within a portfolio I have a mixture of stocks. I have non-traditional companies such as ACAS and traditional dividend companies such as JNJ; and for some such as PG I just can't make the numbers work, so I haven't nought to this point.

Best Wishes,

D4L

2

Written by: Lazy Ninja

Posted on: April 11, 2008 at 2:59 am

Hhhmmm, I confess to hoping for above average dividend growth from a couple of lower-yielding stocks (i.e. SC/CNR). I prefer an initial yield of 3-4%, but won't hesitate to make exceptions.

Jungleguy: Do you target an average dividend yield from your portfolio?

I also really like MSN finance, but still find that information-gathering is a problem for me. I try to cobble information together from globeinvestor,yahoo finance, big charts, MSN, and any individual company websites.

Any other favorites?

3

Written by: Financial Jungle Guy

Posted on: April 11, 2008 at 7:08 am

Hey Ninja - I tend to favour 3-4% yield although I don't invest in them exclusively. After all, I own some SAP, ECA, CNR, TEVA and KEYN shares.

As for websites, the ones you listed are my favourites as well. In addition, I occasionally visit TD WebBroker, Topix and Reuters.

4

Written by: [Weekly Dividend Investing Roundup - April 11, 2008 » The Dividend Guy Blog](#)

Posted on: April 11, 2008 at 12:31 pm

[...] Financial Jungle referenced my post on high dividend payouts = better earnings performance. In this post he gave some highlights from a bunch of the research done by Tweedy Browne (pdf). For more on this see my sidebar under The Dividend Key. [...]

5

Written by: [Hanks Weekly Hangouts #25 \(April 13, 2008\) | My Investing Blog](#)

Posted on: April 13, 2008 at 8:02 am

[...] FinancialJungle shows the benefits of high yield dividend stocks in todays [...]

6

Written by: gorgonono

Posted on: April 14, 2008 at 11:02 pm

"The deepest sin against the human mind is to believe things without evidence."

What's the evidence for that?

7 Written by: [Financial Jungle - » Canadian Dividend Stocks Are Flexing Muscles Too](#)

Posted on: April 16, 2008 at 6:06 am

[...] mentioned in my High Yielding Dividend Stocks Flexing Muscles post, 12 independent studies concluded that investing in high yielding dividend stocks was a [...]

8 Written by: [Blogs and Free Money - April 18,2008](#)

Posted on: April 18, 2008 at 1:21 pm

[..]Financial Jungle presented High Yielding Dividend Stocks Flexing Muscles, which is basically a summary of a research from Tweedy Brown[..]

9 Written by: [stock basis data download](#)

Posted on: April 19, 2008 at 7:14 am

[...] percentages of their earnings to shareholders tend to outperform their stingy counterparts. This [ishttp://financialjungle.com/2008/04/10/investing/high-yielding-dividend-stocks-flexing-muscles/Shaw](http://financialjungle.com/2008/04/10/investing/high-yielding-dividend-stocks-flexing-muscles/Shaw) Announces Second Quarter With Continued Subscriber Growth, Solid Financial Results and Updated [...]

10 Written by: Divs

Posted on: May 26, 2008 at 9:34 pm

I love dividends, but remember that back in the heyday dividend yield could be as high as 10-15%...now days they are 3-4%...its much different in this day and age as companies lower their dividends. But on a after-tax basis (in Canada atleast), nothing beats dividend income.

11 Written by: [Finding a Legitimate High Yield Investment | Loanio](#)

Posted on: November 24, 2008 at 10:02 am

[...] Program, or the acronym HYIP, and many of them quiver. This is not completely unnatural, because high yield investments only come with high risks, and most HYIP opportunities are not even legitimate to begin with. There [...]

12 Written by: Austin

Posted on: December 14, 2008 at 7:10 am

The only way to make money in the long term with any stock is to buy stocks that are going to be a good business to own and hopefully are undervalued.

[Investing In Stocks](#)



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