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Why Dividend Paying Stocks Tend to Fall Less During Bear Markets

By Joshua Kennon, About.com Guide

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After writing the in-depth tutorial, [All About Dividends](#), I thought it might be helpful to explain to you why stocks that pay dividends tend to fall far less than their non-dividend paying counterparts. For many investors, this is a major part of the appeal as they can't stomach huge drops or volatility. Of course, stocks are always going to be riskier than most other asset classes. On the whole, dividend paying stocks tend to display far more consistency than other enterprises.

Here are the four major reasons why dividend-paying stocks tend to fall less during bear markets:

1. The Quality of Earnings is Higher.

It's hard to fake cash. When shareholders get checks in the mail, there is at least some proof that the earnings aren't just accounting magic. This makes people more comfortable holding the stocks during uncertain times because they know there is some value there.

2. Dividend paying stocks generate current income.

In depressions, recessions, or bear markets, many people may find themselves unemployed or earning less than they did during boom years. During times like this, you don't want to part with something that consistently brings in funds for your family to use to buy groceries and gas unless you must. Typically, the shares of high growing, low payout stocks are the first, and hardest, to fall because you can't use them to keep the power bill paid.

3. These stocks become "yield supported".

As share price falls, the cash dividend divided by the share price, known as "dividend yield", gets higher. Imagine if a \$20 stock paid a \$1 annual cash dividend. That's a 5% return, which you would compare to all kinds of other available options such as money market accounts, bonds, etc. If the stock fell to \$10 per share, the yield would suddenly be 10%. The stock would become more attractive and people or companies that did have excess funds, such as insurance groups or international corporations not damaged by domestic problems, are lured in by the relatively higher returns they can earn. If a company is healthy, in a world of 5% interest rates, it's highly unlikely that it's going to have a dividend yield of 15% or 20% because someone, somewhere, with a whole lot of cash is going to step into the situation.

4. Management doesn't have as much capital to allocate.

Human nature being what it is, it's often normal for executives to want to go on an empire-building spree, even if it means earning less attractive returns than their shareholders could if the money was put back into their hands. An established dividend policy solves a big part of this problem by limiting the funds that are available for stupid, overpriced acquisitions or gold-plated faucets in the bathroom.

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