Morgan Stanley

Dividend Stocks Tend to Outperform[i]

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Cash Generating Stocks Have a Long History of Superior Investment Returns[ii]

In my 35 years as an investment professional, I have read most of the seminal works, studies, and academic research papers on investing. There is a large body of academic research that shows a long-term historical trend of dividend stocks beating non-dividend stocks.[iii] There are three primary reasons that dividend stocks, as a whole, tend to do better[iv][v][vi]. Let's look at each, individually.

1. Dividend stocks often have higher quality earnings -- you can't fake cash.[vii]

There are a lot of estimates in accounting. In the short term, it can be easy for management to make profits on the income statement appear higher or lower than they actually are.

The practice of lowering record earnings one period through the use of accounting methods, only to reverse those conservative estimates during a poor period had at one time been almost common.[viii] Seeing through to the business reality can be difficult if you aren't aware of the techniques needed.

That is where dividends come to the rescue. One thing you cannot fake is cash. When a company mails you a check, that money is yours. It can be fairly surmised that companies with a long history of regularly increasing dividend payouts are, in fact, making money.

2. Dividend yields can support a stock during a market crash. [ix]

During major stock market meltdowns, strong dividend stocks tend to hold up much better than non-dividend paying stocks. The reason is due to "yield support".

Imagine that you have two stocks. The first is one of the most financially sound companies in the world but doesn't pay a dividend. The second is the same size as the first but pays a dividend that is about a 2.75% yield.

Imagine the stock market collapses and both your stocks are down 50%. Your second stock is still sending you your dividends in the mail each year. That means the dividend yield is now 5.5%. If you had to sell shares, which would you give up first: the first stock that pays no dividend or the second that does? Most people keep the stock that pays them dividends.

And if there are investors with cash, the odds are good they are going to be attracted to a high dividend yield, and buy shares of the dividend paying stock, putting a floor under the stock.

3. Pressure on management to be more selective about uses of cash.[x]

When a firm has to send 30% to 50% of earnings back to the owners, it imposes discipline. It is one of the psychological restraints that are responsible for the superior returns generated by dividend stocks over long periods of time.

Charlie Munger once commented that, following his and Warren Buffett's death, the quickest way to solve Berkshire Hathaway's capital reinvestment risk would be to pay out most of the earnings as a dividend. The management can't screw up what it doesn't control.

What about High Growth Companies?

Everyone is looking for the next "unicorn" stock and those can be great. Yes, there have been many huge winners and go on to be hugely profitable. Over the years, most of those have never paid a dividend. But do not forget that, as a group, stocks purchased at their initial offering price do poorly compared to the general market.[xi]

Therefore, I would suggest to keep your eye on the cash generating giants that "pound out money" for shareholders. It's a wonderful thing to be sitting at home and see cash come into your accounts. If you've selected your holdings wisely, I believe that figure should grow significantly over the years.

It Really Does Matter

While an extra percentage point here or there may not seem like much, consider this:

An investor saving $10,000 per year, who earned 7% on his money, would end up with $4,065,289 after fifty years. A similar investor earning 9% per year would end up with $8,150,836. That extra 2% per annum meant roughly double the wealth!

Whether you own small stocks, large stocks, value, growth, international or emerging market stocks, the message is the same. On balance, you have a better chance of accumulating wealth owning a portfolio of companies that pay a dividend than if you own a portfolio of companies that don't.[xii]

Is This <u>All</u> There Is?

These findings apply to most situations, but not to all. A body of knowledge has been gathered through thousands of interactions with accomplished professionals. Further detail is reserved for clients.

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i Jeremy J. Siegel, *Stocks for the Long Run" 5th Edition, McGraw hill 2015 Figure 12-2, Returns to S&P500 Stocks Ranked by Dividend Yield, 1957-2012, page 180-181*
ii IBID
[iii] Jeremy J. Siegel, *The Future For Investors*, 2005, Crown Business, p.127
[iv] Jeremy J. Siegel, *Stocks for the Long Run" 5th Edition, McGraw hill 2015 "Dividends and Corporate Governance", page 133-134*
[v] Jeremy J. Siegel, *The Future For Investors*, 2005, Crown Business, p.142 *"The Bear Market Protector",*
[vi] Jeremy J. Siegel, *The Future For Investors*, 2005, Crown Business, *"Capital Pigs" Figure 7.1 Return to S&P 500 Firms Sorted By Capital Expenditures/Sales Rations, 1957-2003" p.106-107*
[vii] Jeremy J. Siegel, *Stocks for the Long Run" 5th Edition, McGraw hill 2015 "Dividends and Corporate Governance", page 133-134*
[viii] "Financial Restatement: Trends in the United States 2003-2012, Susan Scholz, Center for Audit Quality, P. 3-5.
[ix] Jeremy J. Siegel, *The Future For Investors*, 2005, Crown Business, p.142 *"The Bear Market Protector",*
[x] Jeremy J. Siegel, *The Future For Investors*, 2005, Crown Business, *"Capital Pigs" Figure 7.1 Return to S&P 500 Firms Sorted By Capital Expenditures/Sales Rations, 1957-2003" p.106-107*
[xi] Ibid, p. 85-87
[xii] . Jeremy J. Siegel, *Stocks for the Long Run" 5th Edition, McGraw hill 2015. Figure 12-3 Returns to S&P500 and Dow Jones Industrials and their 10 Highest Yielding Stocks, 1957-2012 page 183*

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