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The Power of Dividends in a Portfolio



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It wasn't so long ago that many investors regarded dividends as roughly the financial equivalent of a record turntable at a gathering of MP3 users--a throwback to an earlier era, irrelevant to the real action.

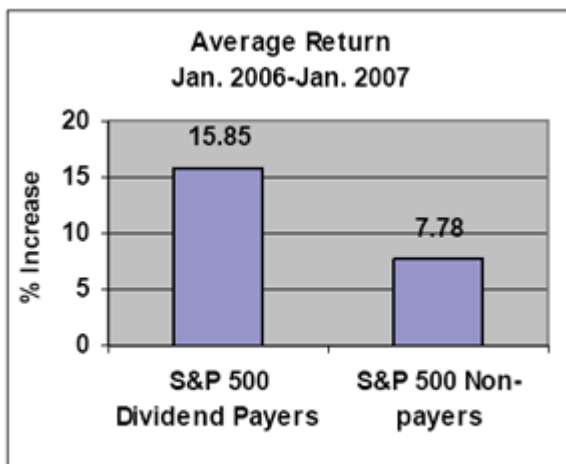
But fast-forward a few years, and things look a little different. Since 2003, when the top federal income tax rate on qualified dividends was reduced to 15% from a maximum of 38.6%, dividends have acquired renewed respect. Favorable tax treatment isn't the only reason, either; the ability of dividends to provide income and potentially help mitigate market volatility also is attractive to investors. As baby boomers approach retirement and begin to focus on income-producing investments, the demand for high-quality, reliable dividends is likely to increase.

In 2006, personal dividend income represented roughly \$696.3 billion- 6.3% of the trillion in personal income in the US that year. That was up from approximately 5.5% in 2004. Interest income represented about 10% of personal income in 2006, compared to 9.2% in 2004.

Source: US Dept. Of Commerce, Bureau of Economic Analysis

Why consider dividends?

Dividend income has represented roughly one-third of the monthly total return on the Standard and Poor's 500 since 1926. According to S&P, the portion of total return attributable to dividends has ranged from a high of 53% during the 1940s--in other words, more than half that decade's return resulted from dividends--to a low of 14% during the 1990s, when investors tended to focus on growth.



Source: Standard and Poor's

We believe that a successful wealth management relationship starts with clarity of purpose.

Before embarking on any plans or strategies with our Client, we first seek to develop a clear understanding of your personal and financial goals.

We then work with you to select and implement strategies that will help you move toward your goals.

If dividends are reinvested, their impact over time becomes even more dramatic. S&P calculates that \$1 invested in the Standard and Poor's 500 in December 1929 would have grown to \$57 by September 2005. However, when coupled with reinvested dividends, that same \$1 investment would have resulted in \$1,353. (Bear in mind that past performance is no guarantee of future results, and taxes were not factored into the calculations.)

Dividends can be especially attractive if the market is producing relatively low or mediocre returns. If a stock's price rises 8% a year, even a 2.5% dividend yield can push its total return into the double-digit range; in some cases, dividends could also help turn a negative return positive. Also, many dividend-paying stocks represent large, established companies that may have significant resources to weather an economic downturn.

The corporate incentive

Financial and utility companies have been traditional mainstays for investors interested in dividends, but other sectors of the market also are beginning to offer them. For example, investors are stepping up pressure on cash-rich technology companies to distribute some of their profits as dividends. In June 2007, the number of companies offering dividends was 3% higher than the year before, according to S&P, though increases in the amounts paid have been slowing in recent years.

Dividends are by no means guaranteed; a company's board of directors can decide to reduce or even eliminate them. However, a steady and increasing dividend is generally regarded as one sign of a company's ongoing health and stability. For that reason, most corporate boards are reluctant to send negative signals by cutting dividends.

Look before you leap

Investing in dividend-paying stocks isn't as simple as just picking the highest yield. Some dividends, such as those paid by real estate investment trusts (REITS) and master limited partnerships, don't qualify for the 15% maximum tax rate, and a portion may be taxed as ordinary income. If you're investing for income, consider whether the company's cash flow can sustain its dividend. Also, the 15% rate is scheduled to expire at the end of 2010, and there is no guarantee dividends will continue to receive favorable tax treatment.

If you're interested in a dividend-focused investing style, look for terms such as "equity income," "dividend income," or "growth and income." Also, some exchange-traded funds (ETFs) track an index comprised of dividend-paying stocks, or that is based on dividend yield; be sure to check the prospectus for information about expenses, fees and potential risks, and consider them carefully before you invest. A financial professional can evaluate the role dividends might play in your portfolio.

Our total wealth management services can help you with these very important questions. For more information, please contact your Stage 2 Consultant.

Warmest Regards,

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