

April 1, 2010

## **The Power of Dividends**

The first quarter of 2010 closed with a gain of 4.9% in the S&P 500, continuing the rebound off the recession low set in March 2009. Despite an early selloff of just over 8%, investors focused on improving economic data and steadily pushed prices higher as the quarter closed. Reported earnings generally met or beat expectations, with many companies voicing upbeat guidance for the year ahead, showing confidence that the economic recovery will continue. The S&P now rests about 75% above the year ago low, and for a little perspective of the depth of the recession, remains just over 25% lower than the all-time high set in October 2007.

We have discussed the wisdom of diversification when investing many times in recent years. We learned from observation that even companies considered to be “blue chip” or market “bellwethers” could suffer mightily when things go awry. Consider stocks such as General Electric or Bank of America, each now selling for less than a third of their highs over the past decade, not to mention other once-big names such as Worldcom, Enron and Bear Stearns that no longer exist. Real estate ownership during the same period provided no safe haven for over-leveraged investors as prices tumbled from unsustainable levels. Portfolio diversification should be at the very top of every investor’s list of priorities when setting up an investment strategy. Today, we would like to spend a few paragraphs discussing another top priority in today’s environment; dividends.

Total return of stocks is defined as the sum of dividends paid plus capital appreciation over a given time period. Since 1926, dividends have contributed over a third of the total return on stocks while capital appreciation has contributed two-thirds. Investors often focus solely on stock price to produce gains, and in doing so miss out on a critical component of the total return picture. The ability to consistently increase dividends annually is an important measure of management’s confidence in their ability to grow the business and demonstrates their willingness to share profits with stakeholders. We’ve all heard of companies making bold predictions about prospects, but there is no stronger statement than getting a check deposited to your account each quarter.

Dividend rates can be looked at in several ways. Companies offering high dividends often have limited growth prospects, thus capping the potential for price appreciation. The high dividend serves as a support for the price of the stock in the absence of earnings growth. In other situations where the percentage growth of the dividend equals that of earnings growth, the total return, while positive, may be somewhat muted when growth slows. The sweet spot of total return investing is driven by a third situation, when a company has a strong return on equity (ROE), which then produces above average long-term dividend growth *and* price appreciation of

the stock, thus providing the investor with above average returns. The power of dividends is an important consideration when constructing diversified, well-balanced portfolios. At Abbot, we have long focused on companies with the ability to deliver strong ROE, and will continue to do so in the global environment we live in.

The optimism expressed in our year-end 2009 newsletter is playing out as expected, at least so far. However, it is not our nature to pass up an opportunity to fret out loud, if only to remind us that markets climb a wall of worry. The economic recovery continues, with the Index of Leading Economic Indicators, through January, now up for eleven consecutive months. Interest rates remain at historic lows, courtesy of the Federal Reserve, but hikes in rates are sure to follow any economic rebound. So, you may ask, what's not to like? Well, despite the many positive signs that exist, there are lingering concerns. These include: the unemployment rate, the FED exit strategy from the massive spending that has been done to lift us from recession, and mounting losses in the commercial real estate sector to name a few. The hope is that improving productivity will become self-sustaining and will thus offset these issues allowing the economic and stock market rebounds to continue.

Whether at the "home office" in North Andover or the satellite office in South Carolina, it is always a pleasure to meet in person or speak on the phone with our clients. The investment process is constantly evolving, be it the investment climate or individual financial objectives and goals, so please call us if you have any questions, concerns or comments. And finally, if you have family or friends that you think may benefit from our services, we would be pleased to speak with them.

#### **1<sup>st</sup> Quarter Scoreboard**

Dow Jones:	+4.1%
S&P 500:	+4.9%
Nasdaq:	+5.7%



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