CIBC Wood Gundy
One to One Insights
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Floating on the dividend stream

It's been a challenging time for income-oriented investors, with sovereign bond yields in many countries hovering near record lows, in part as a result of global growth concerns and political uncertainties. However, dividend-paying stocks have a history of delivering capital gains, regular income and relative stability through a variety of market conditions. Let's look at what dividends are, the kinds of companies that pay dividends, and then examine the opportunity dividend-paying stocks present.

What are dividends?

A company can make use of its profits in a number of ways. One option is to pay dividends—often measured as a dollar amount per share—to shareholders. Paying dividends can help a company demonstrate to shareholders that it's in good financial shape and confident about its outlook.

What kinds of companies pay dividends?

Companies that pay dividends—especially those with a history of steadily increasing their dividends—typically have certain similar characteristics that tend to make their shares less volatile.

Well-established companies
Companies that pay dividends are often well-established, large businesses. Paying dividends to shareholders is a sign of a company's financial stability and viability. As well, as dividend-payers are often more mature businesses, their share prices also tend to be more stable.

Companies with a disciplined approach
Dividend-paying companies often take a more cautious and prudent management approach. Management generally tries very hard to maintain or increase a company's dividends.

A dividend increase can attract both income investors and those looking for capital gains. When investors see a rising dividend, they often interpret it as a sign of the company's strength and profitability.

If a company cuts its dividend, the stock market can devalue its share price. Investors may fear that a dividend cut means the company is in financial trouble, experiencing lower sales, higher expenses and declining profits. In addition, investors who depend on a regular income stream, even if they still believe in the company, may switch to another stock simply to maintain their standard of living.

Who can benefit from dividend-paying stocks?

Investors interested in a steady stream of income often focus on investments such as bonds. However, with dividend-paying stocks, investors benefit from the income generated by the dividend as well as the potential for capital appreciation. Although certainly not representative of every dividend stock, sometimes dividends can contribute as much as—or even more than—stock price appreciation to total returns.

"Over the long term, the majority of total shareholder return comes from dividends—a figure that some peg as high as 60%, 70% or 80%," said Craig Jerusalim, Portfolio Manager, Canadian Equities at CIBC Asset Management, in a recent podcast.[1]

That doesn't mean investors who are seeking stability should flock to stocks paying the highest dividends. According to Jerusalim, "It's imperative to focus on dividend sustainability and dividend growth opportunities, rather than outright yield."

What's the opportunity today?

"How we go about identifying dividend-growth companies would be focusing on companies who have a lower payout ratio," explained Stephen Carlin, Managing Director and Head of Equities at CIBC Asset Management, in another podcast.[2] "The lower the better … If it's low, there's a better chance that a company will have an opportunity to grow those dividends over time."

Companies paying low dividends may also present attractive buying opportunities for investors whose priority is price appreciation and dividend growth rather than generating income. That's because companies paying lower dividends are typically less attractive to income investors looking to supplement low bond yields.

It's important to keep in mind that dividend-paying stocks are equities, and their performance is subject to the ups and downs of the markets as well as internal company decisions to cut, maintain or raise dividend payments. However, when carefully selected, they could help you both manage equity risk and boost your total returns.

There's another advantage too: holding Canadian dividend-payers may save you taxes in your non-registered accounts, compared to investments earning ordinary income, thanks to the federal and provincial dividend tax credits. Contact us to discuss how dividend-paying stocks may fit into your tax planning and investment strategy. If they do, we can help you determine whether it's best to hold them directly or to gain exposure through an exchange-traded fund or mutual fund. Clients are advised to seek advice regarding their particular circumstances from their personal tax and legal advisors.

1 *Advisor.ca, Best ways to predict dividend growth, www.advisor.ca/togo/best-ways-to-predict-dividend-growth, March 10, 2016*

2 *Advisor.ca, Dividend stocks an alternative to bonds, www.advisor.ca/togo/dividend-stocks-an-alternative-to-bonds, September 8, 2015*