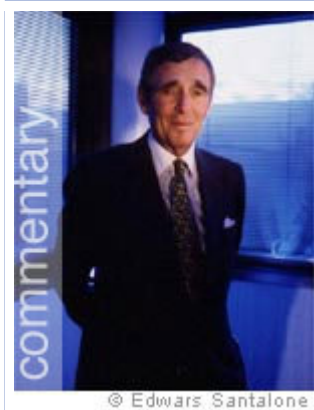


Why Dividends Matter (http://www.forbes.com/forbes/2004/0419/106_print.html)

David Dreman, 04.19.04, 12:00 AM ET



Widow-and-orphan stocks, meaning those that pay high dividends, are back in vogue. Recent tax code changes have dropped the rate for dividends from high ordinary income levels (35% top bracket) to a maximum of 15%. The change has inspired companies to initiate or hike dividends.

But there is more. Contrary to conventional wisdom, dividend-paying stocks do better in the long run than do nonpayers--and those with the highest payouts do best of all. Sure, in the manic 1990s investors flocked to nonpayers, mainly hot tech stocks. But when you ride through years of bull and bear markets, dividend stocks have the edge. Seeking the next Dell Computer, investors pay too much for growth and wind up with disappointments.

A Standard & Poor's study of total returns (price appreciation plus dividend income) shows that payers outdistanced nonpayers by 1.9 percentage points annually from 1980 through 2003.

Another study paints an even brighter picture for dividend-issuing stocks. This study, which I conducted in collaboration with Vladimira Ilieva of the Institute of Psychology & Markets in Jersey City, N.J., looks at a broader universe of equities, the Compustat 1500 (1,500 of the largest companies trading in U.S. markets), and goes back longer, to 1970. We sliced up the 1,500 names into quintiles according to payouts and compared the top with the bottom layers (the bottom was mostly nonpayers, with the rest low-yielding issues).

The contrast is stark (*see table, below*). From 1970 through 2003 the top fifth of the payers had an annual 14.5% total return, while the lowest-yielding group gave you only 8.8%. The highest yielders also outperformed both the Compustat average and the S&P 500 by 1.9 and 3.2 points annually over the 34-year life of the study.

What about the past ten years, which covers the mid-1990s bubble, the bust that started in March 2000 and the (lately fitful) recovery under way since fall 2002? This period is a perfect illustration of how solid dividends can sustain you through market extremes. The stodgy old-style stocks, buoyed by their quarterly dividend checks, did very well here, too. Over the past ten years the highest-yielding stocks returned 13.3%, a full 4.2 points better than the low-yield bunch.

In fact, high-dividend payers have run ahead of the market since the start of this year, possibly indicating a swing back to better-quality equities and away from speculative high-tech issues.

Yes, anyone can quibble with these findings, but the bottom line is that both our study and S&P's show conclusively that the supposedly safe stocks delegated for widows and orphans outperform by a country mile more risky stocks bought for capital appreciation.

A caution: Although many common and preferred stocks qualify for the 15% tax rate, some stocks, like those of real estate investment trusts, do not. Before putting high-yielders in a taxable account, make sure that they qualify for the lower rate.

Here are several stocks with high yields and good prospects:

Ameren (nyse: [AEE](#) - [news](#) - [people](#)) (**46**) is a utility that delivers electricity and gas to 2.2 million customers in Missouri and Illinois. It trades at 14 times trailing earnings. Earnings growth is in the low single digits, but its strong finances should safeguard the 5.5% yield and permit an increase.

With its coming acquisition of Fleet Boston Financial, **Bank of America** (nyse: [BAC](#) - [news](#) - [people](#)) (**80**) will be the country's third-largest bank. The merger, likely to be consummated in April, should prove moderately dilutive. Nonetheless, BofA should still show earnings growth of 5% this year and in double digits next year. The stock trades 11 times earnings and yields 4.0%.

UST (nyse: [UST](#) - [news](#) - [people](#)) (**35**) has a 70% market share in smokeless tobacco. Earnings have been growing in the low single digits in the last few years, as low-cost brands have gained. This is likely to prove a temporary

phenomenon: UST is beefing up marketing and is pushing its own low-cost brand, Red Seal. It's cheap at 12 times earnings. It pays a 5.9% dividend, which has been hiked in all but one of the past 18 years.

Paying You to Own Them

The top-yielding 20% of the Compustat 1500 outdoes everyone else in total return (capital gains plus dividends), especially the lowest-yielding quintile--mostly nondividend payers.

	ANNUALIZED TOTAL RETURNS		
	10-Year (1994 - 2003)	20-Year (1984 - 2003)	Since Inception (1970 - 2003)
Compustat 1500 High yield	13.3%	14.7%	14.5%
Low yield	9.1	9.7	8.8
Compustat 1500	11.1	12.6	12.6
S&P 500	11.0	12.9	11.3

Source: Dreman Value Management.

David Dreman is chairman of Dreman Value Management of Jersey City, N.J. His latest book is *Contrarian Investment Strategies: The Next Generation*. Visit his homepage at www.forbes.com/dreman .