The essentials of dividend investing: A conversation with three dividend investing experts, Part 1 of 2

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We sat down with PMs Scott Davis, Mike Barclay and Pete Santoro to get their most relevant insights on dividend investing today. Part two, coming soon.

Who should think about investing in equity income?

MIKE BARCLAY: There are some obvious categories: for example, investors who are close to or in retirement and want their money to last through retirement. But even for younger investors, I’d say this is a way to have equity exposure with relatively low risk. Equity income takes a long-term approach to investing in the markets — including staying invested through down markets. So we’d argue that it should be a core part of every investor’s portfolio — and they could use either higher beta or more risky strategies as satellites to capture upside in strong up markets.

What are the biggest misconceptions about dividend investing?

PETE SANTORO: There’s certainly a misconception that you should focus on yield. But yield for the sake of yield is not a compelling strategy, and here’s why: Just because a company has a history of paying dividends doesn’t mean it will continue to do so. Dividends are not guaranteed by companies. They’re issued at the sole discretion of the board of directors of an individual company. So look for companies that have the ability to pay and grow those dividends over time, providing income for investors going forward.

MIKE BARCLAY: I agree. The dividend is only going to be as good as the underlying fundamentals of the company. If fundamentals remain strong, the stock price will reflect that. What’s really important is sustainable income that can grow over time.

SCOTT DAVIS: Whenever I hear that someone is using dividend yield as a valuation tool, it scares me. Dividend yield is a simple ratio: it’s the current dividend paid divided by the price. There’s very little information in that. It doesn’t tell you whether the dividend can be sustained or anything about the cashflow or balance sheet of a company.

PETE SANTORO: A total return approach is the best way to go about it. Yes, dividends are a very important part of the total return structure — since 1930, over 40% of stocks’ total return has come from dividends. But the other 60% is also important, and that’s the capital appreciation.
How can investors find companies that can pay a dividend over time and continue to grow it?

MIKE BARCLAY: It really comes down to cashflow: a dividend can only be sustained and grown over time if cashflow grows over time. You need to ask: What pays the dividend? The other element that's really important is looking at the balance sheets, because in stressed environments, companies with the strongest balance sheets can access capital. They can sustain a dividend even if cashflows take a hit in a downturn. When a company is over-levered, it may have to make desperate decisions, and more often than not, it may have to cut its dividend. When you're thinking about sustainable and growing dividends, you have to focus on the cashflow, before you even worry about whether the dividend is going up or what the yield is.
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