

## Dividend Investing

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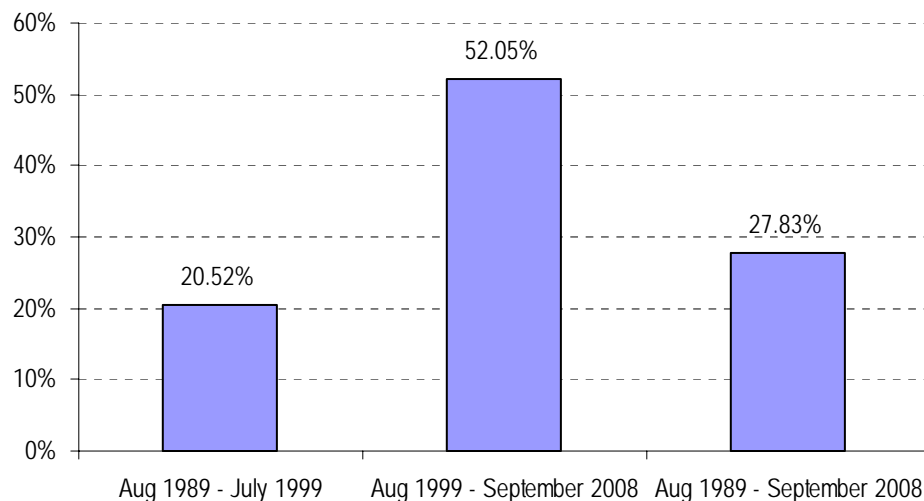
- In light of the current equity environment, dividend yield based strategies, which concentrate on both income and capital appreciation, may be pursued to obtain more stable return patterns.
- Dividend yield is the less volatile component of the total return and is more predictable than price appreciation.
- Historically, dividends have contributed nearly one-third of the equity return of the S&P BMI World Index, while capital appreciation has contributed approximately two-thirds.
- Dividends allow investors to capture the upside potential while providing downside protection in the down markets.
- When bond yields are low, income oriented investors can switch to dividend paying stocks to enhance current income.
- The S&P Dividend Investor Series offer a suite of dividend indices that are designed to accommodate absolute high yield seeking investors as well as those looking for stable, consistent payouts.

## The Importance of Dividends

In light of the recent turmoil in the global equity markets, dividend yield has resurfaced as a crucial component of the total equity return. With the S&P BMI World Index down 24.08% year-to-date, as of September 2008, it is important to revisit the role of dividends and their defensive positioning during such volatile periods.

From August 1989 to September 2008, dividends contributed approximately 28% of the total equity return of the S&P BMI World Index, while price appreciation contributed roughly 72%. From August 1999 to September 2008, dividend income accounted for as much as 52.05% of total return. Exhibit 1 plots the contribution of dividends to the monthly total returns of the S&P BMI World Index over the last 19 years.

**Exhibit 1: Dividend Income as a % of Monthly Total Return of the S&P BMI World Index**



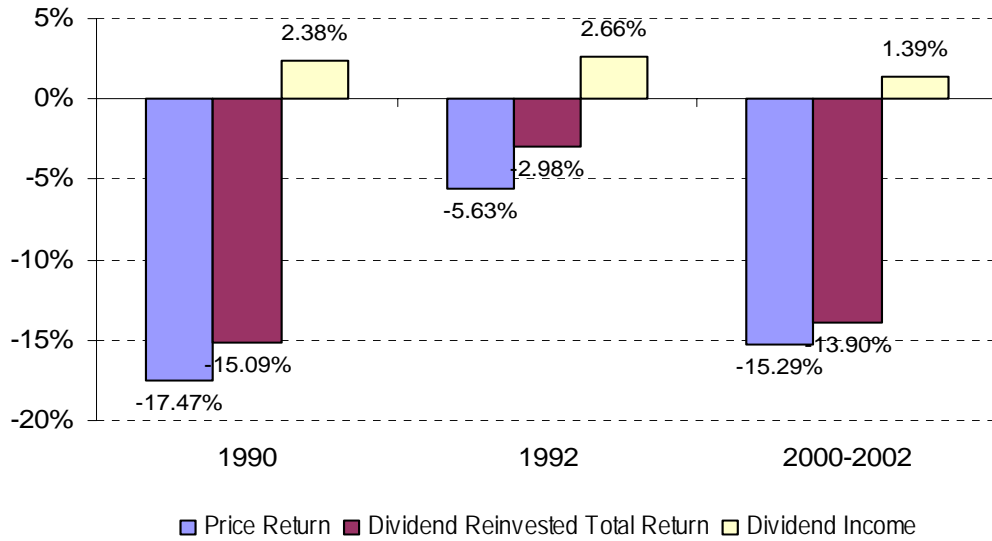
Source: Standard & Poor's. Figures are from August 1989 –September 2008.

## Downside Protection

In addition to providing a steady source of income for investors, dividends also play another important role during periods of volatility. While price returns can be either positive or negative, dividend incomes are by definition positive. This provides a cushion during negative equity markets. Standard & Poor's studied the returns of the S&P BMI World Index during the last three market cycles, and examined the role of dividends during those time periods. We defined an up market as a time period of one calendar year or more during which market returns are positive, and a down market as a time period of one calendar year or more during which market returns are negative. As shown in Exhibits 2 and 3, in the last three completed up markets, dividend yield

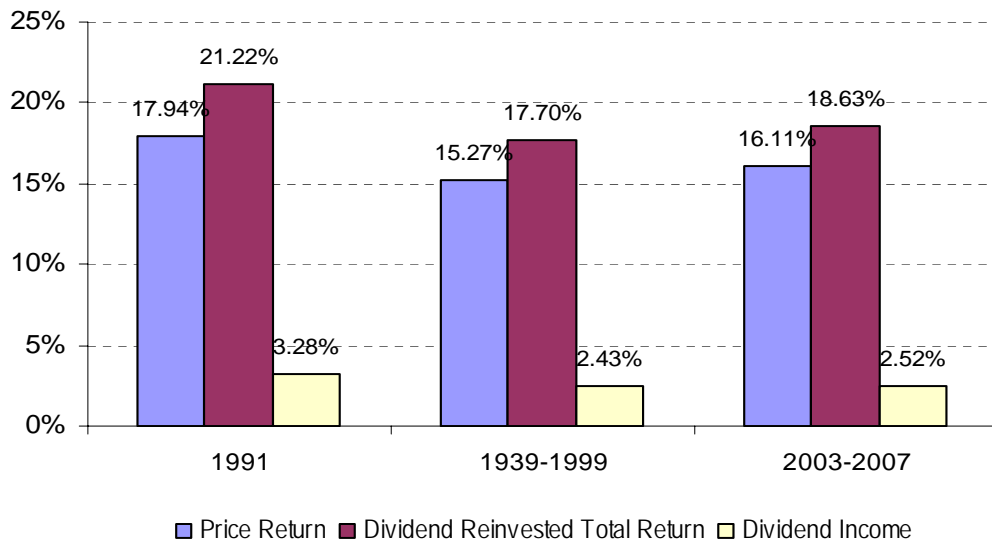
contributed an average of 14.29% of the total return. During the last three down markets, dividend yield accounted for 20.12% of the total return.

**Exhibit 2: Dividend Income During Down Markets**



Source: Standard & Poor's. Periods longer than one year are annualized.

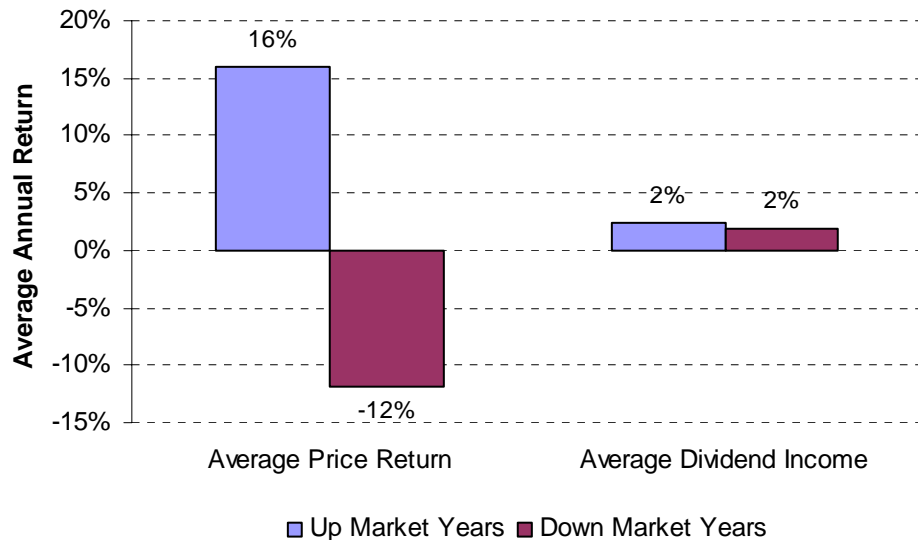
**Exhibit 3: Dividend Income During Up Markets**



Source: Standard & Poor's. Periods longer than one year are annualized.

Fuller and Goldstein (2004) examined the return behavior of dividend paying and non-dividend paying firms in both up and down markets, from January 1970 to December 2000. The authors found that dividend-paying firms outperformed non-paying firms more in down markets than they did in up markets. Therefore, dividends allow investors to capture the upside potential while providing downside protection in negative markets.

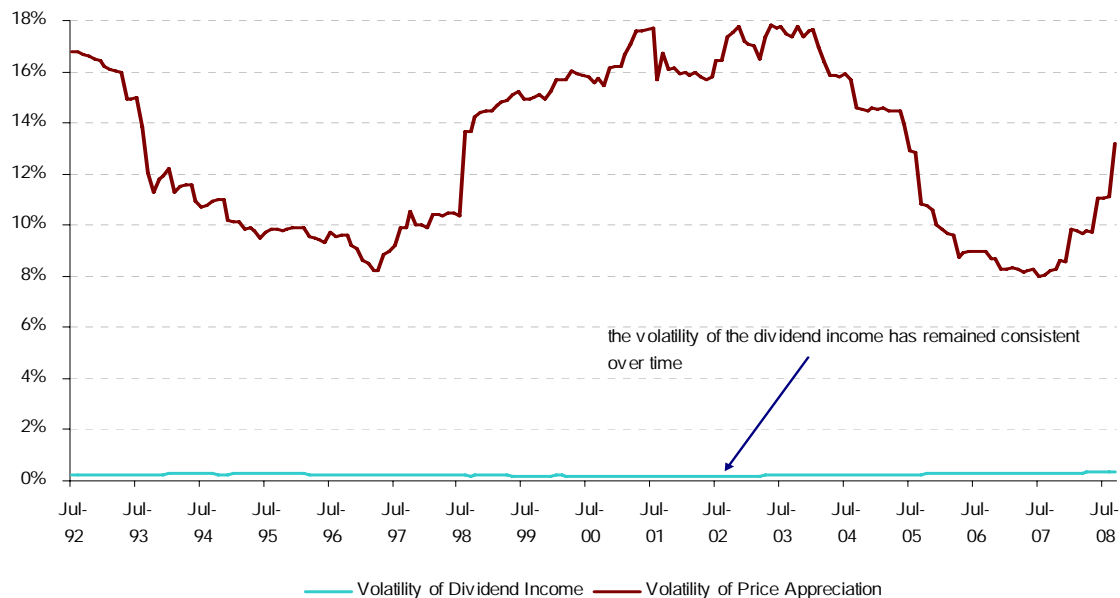
**Exhibit 4: Dividends Act as a Cushion During Negative Equity Markets**



Source: S&P BMI World Index. Figures are from January 1990 – December 2007.

Not only are dividends positive, they are relatively stable through time. Wide swings in stock prices can be partly attributed to speculation and market sentiment; whereas dividend income, as a component of a company’s earnings, is less subject to speculation. Over the time period 1989 - September 2008, the standard deviation of annual price returns is 13.96%. In contrast, the annualized standard deviation of dividend return is 0.27% over the same investment horizon. Exhibit 5 illustrates the constant volatility of dividend income from 1991 - September 2008. The lower volatility makes dividend income more stable over different market cycles.

**Exhibit 5: Rolling Three-Year Standard Deviation of Dividend Income and Capital Appreciation**

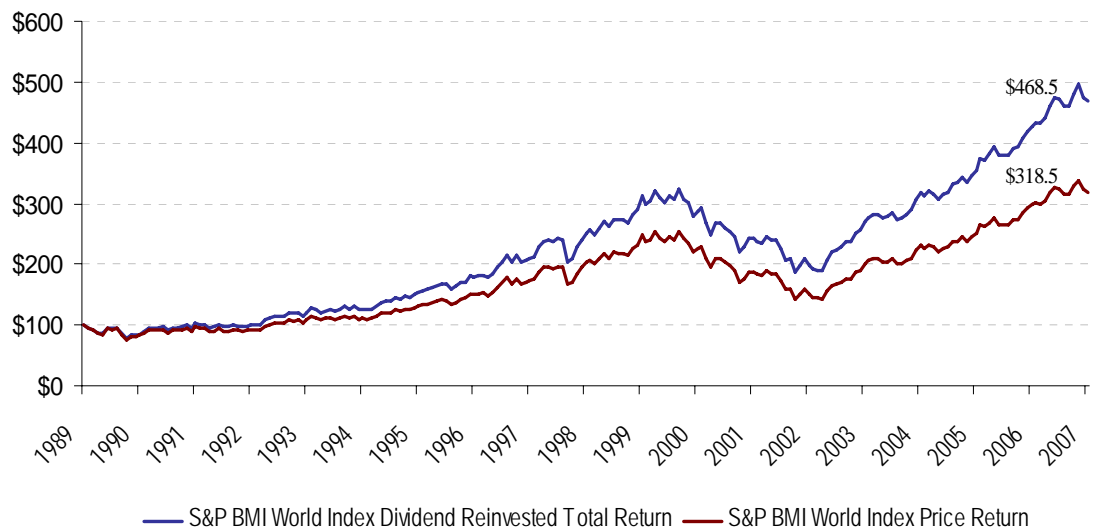


Source: S&P BMI World Index. Data from July 1991 – September 2008.

The Compounding Effect of Dividend Income

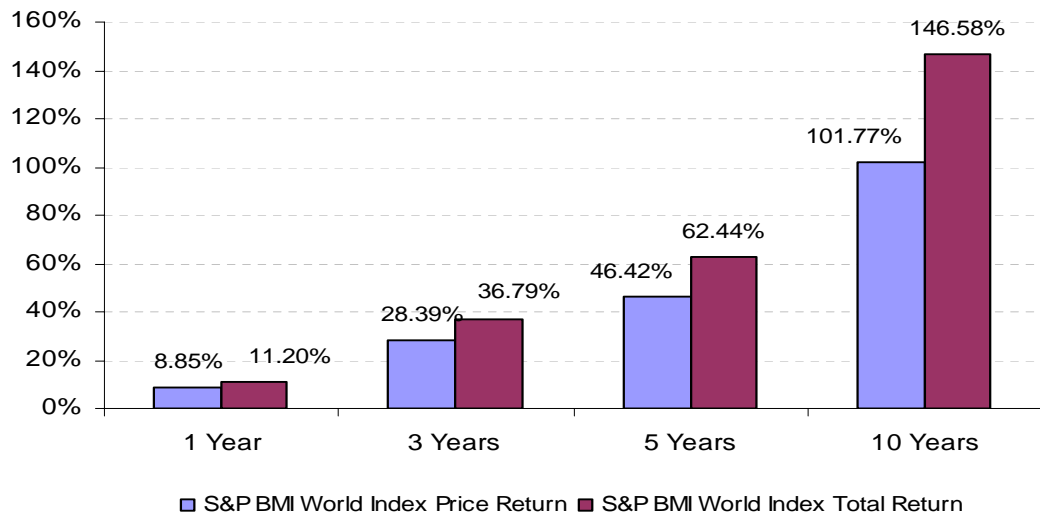
Another important aspect of dividends can be observed through the effect of compounding, as illustrated in Exhibits 6 & 7. Excluding dividends, a US\$ 100 investment made in the S&P BMI World Index on January 1, 1999 would have grown to US\$ 318.5 by the end of 2007. During the same investment horizon, a US\$ 100 investment with dividends reinvested would have yielded US\$ 468.50. Exhibit 7 plots this compounding effect for the S&P BMI World Index over several time horizons. The plotted figures are averages for every continuous investment horizon, over each time period, based on monthly data for the last 18 years, ending 2007.

**Exhibit 6: S&P BMI World Index Cumulative Return from 1989 - 2007**



Source: Standard & Poor's.

**Exhibit 7: Compounding Effect**

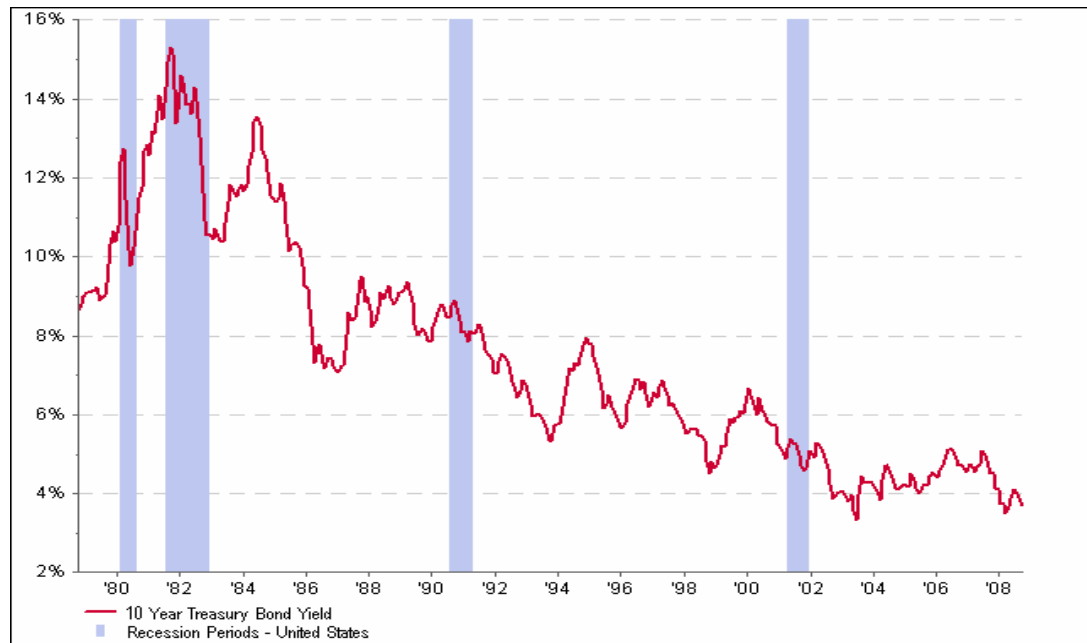


Source: Standard & Poor's. Average returns calculated from monthly 1, 3, 5, 10 year returns from Jan 1990 – December 2008.

### An Alternative to Low Bond Yields

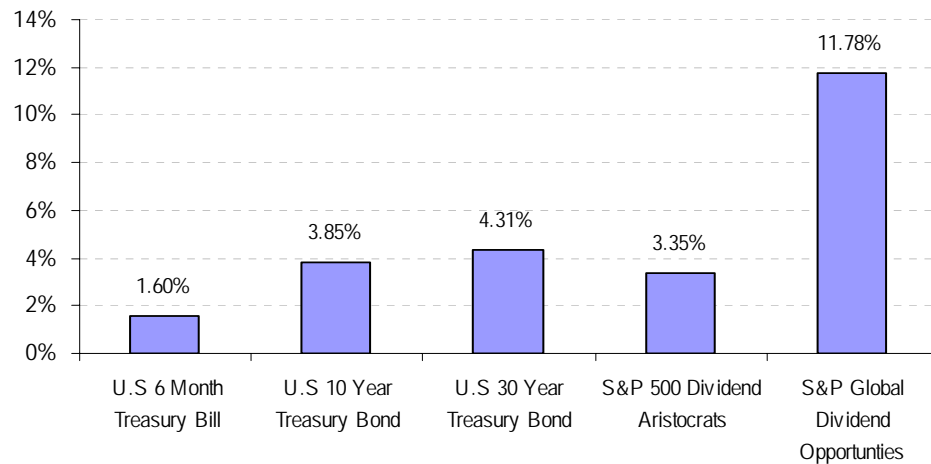
As seen in Exhibit 8, the yields on Treasury bonds have dropped to one of their lowest levels in years. For income oriented investors, low bond yields are detrimental to their cash flow needs. By diversifying the source of income beyond bonds through investing in dividend based strategies, investors can supplement current income. Exhibit 9 plots the current yield on the short-term and long-term Treasury bonds versus the yield on the S&P 500 Dividend Aristocrats and Global Dividend Opportunities Indices.

**Exhibit 8: 10 Year Treasury Yield over Time**



Source: FactSet, Standard and Poor's. Data from January 1979- September 2008

**Exhibit 9: Bond Yield vs. Stock Yield**



Source: Standard and Poor's. Data as of September 30, 2008.

### The S&P Dividend Investor Series

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The S&P Dividend Investor Series offers a suite of yield based investment strategies that are designed to accommodate both high yield seeking investors and those looking for stable payouts. Constituents of the indices in all three sub-families must meet their individual liquidity, exchange listing, tradability and investability criteria. The Series is divided into three sub families to capture all dividend capabilities:

*S&P Dividend Aristocrats* - The S&P Dividend Aristocrats index series are designed to measure the performance of companies around the world that have followed a managed dividend policy of consistent increasing dividends every year for a set number of consecutive years.

*S&P Dividend Opportunities* – The S&P Dividend Opportunities index series are designed to serve as benchmarks for global income seeking investors. The indices seek to provide exposure to high yielding common stocks from around the world while meeting sector and country diversification, tradability, investability and profitability criteria.

*S&P Dividend Alternatives* – The S&P Dividend Alternatives indices are investable benchmarks that represent securities that are intended to provide a regular income stream and that have fairly low correlations to traditional common equity.

*For more information on S&P Dividend Investor Series, visit [www.indices.standardandpoors.com](http://www.indices.standardandpoors.com).*

## References

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Fuller, K., and M. Goldstein, "Do Dividends Matter More in Declining Markets?", October 2004

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## Disclaimers

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