

In the recent report ["GE - Bringing Investment Mistakes To Life,"](#) I discussed the basic investor fallacy of "I bought it for the dividend." However, most importantly, as I noted:

"While I completely agree that investors should own companies that pay dividends (as it is a significant portion of long-term total returns) it is also crucial to understand that companies can, and will, cut dividends during periods of financial stress. During the next major market reversion, we will see much of the same happen again."

As you may already suspect, by looking out our portfolios on the site, we have a preference for high-quality names that also provide dividends. Normally, we screen our database of over 8000 stocks for companies which fit several fundamental and value factors to ensure we are buying top-quality names. However, for today's purpose of a specific dividend focus, we are looking primarily for companies which are members of the S&P 500 index and have a history of growing their dividends over the last 5-years, a declining payout ratio relative to their earnings per share, and we are taking only the top 10 highest rated stocks. The criteria for our Dividend screen are:

- **Market Capitalization > \$1 Billion**
- **Index Constituency: Must Be A Member of the S&P 500 Index**
- **Dividend Yield > 1%**
- **5-Year Dividend Growth Rate > 0**
- **Change In Payout Ratio < 0**
- **Zack's Investment Ranking = Top 10**

The table below are the 10-candidates which resulted from the latest screening.

Company	Ticker	Div Yield	Div 5yr Growth	Change in Payout Ratio	Zacks Rank
S&P 500	SPAL	2.02%	8.04%	0.43	2
S&P Indl	SPIN				
Dow Jones Indl	INDU	2.28%	9.84%	0.09	
DRUGS					
Bristol-Myers	BMJ	3.07%	2.43%	-21.00%	1
MEDICAL CARE					
Anthem Inc	ANTM	1.13%	13.68%	-1.00%	2
ELECTRONIC-SEMICONDUCTORS					
Intel Corp	INTC	2.49%	6.72%	-11.00%	1
ELECTRONICS					
Garmin Ltd	GRMN	3.14%	2.68%	-4.00%	1
INVEST BKRS-MGRS					
Ameriprise Finl	AMP	2.77%	12.36%	-4.00%	2
UTILITY-ELEC PWR					
Amer Elec Pwr	AEP	3.40%	5.31%	0.00%	2
Ameren Corp	AEE	2.84%	3.32%	-9.00%	2
Southern Co	SO	5.35%	3.46%	-3.00%	1
TRANSPORTATION					
Csx Corp	CSX	1.26%	8.11%	-10.00%	1
BUSINESS SERVICE					

The combination of these fundamental measures should yield an excess return over the market during the previous 5-year time frame. **The table below assumes that over the last 5-years you bought all 10-stocks and rebalanced them semi-annually.**

Period	Date	Companies in Portfolio	Tot Return of Portfolio %	S&P 500 Tot Return %	Excess Ret of Screen %	STATISTICS ex.: \$10,000 start	Strategy	S&P 500
1	11/15/13	10	5.70%	5.5	0.2	Total Compounded Return %	86.0%	67.7%
2	05/02/14	10	1.00%	1.2	-0.2	Total Compounded Return \$	18,604	16,772
3	10/17/14	10	16.70%	10.5	6.2	Compounded Annual Growth Rate %	14.4%	11.9%
4	04/03/15	10	-7.00%	-4.3	-2.7	Win Ratio %	90%	90%
5	09/18/15	10	10.00%	3.2	6.8	Winning Periods/Total Periods	9 of 10	9 of 10
6	03/04/16	10	13.00%	10.2	2.8	Avg. # of Stocks Held	10.0	
7	08/19/16	10	10.20%	6.2	4.0	Avg. Periodic Turnover %	77.8%	
8	02/03/17	10	3.40%	8.6	-5.1	Avg. Return per Period %	6.6%	5.4%
9	07/21/17	10	8.90%	11.8	-2.9	Avg. Winning Period %	8.1%	6.5%
10	01/05/18	10	4.10%	1.3	2.8	Largest Winning Period %	16.7%	11.8%
Average						Avg. Losing Period %	-7.0%	-4.3%
		10.0	6.60%	5.40%	1.2	Largest Losing Period %	-7.0%	-4.3%
Up Markets						Max. Drawdown %	-7.0%	-4.3%
9		10.0	8.10%	6.50%	1.6	Avg. Winning Stretch (# of Periods)	4.5	4.5
Down Markets						Best Stretch (# of Periods)	6.0	6.0
1		10.0	-7.00%	-4.30%	-2.7	Avg. Losing Stretch (# of Periods)	1.0	1.0
Annualized						Worst Stretch (# of Periods)	1.0	1.0
			14.90%	12.10%	2.6			

Over the 21-quarterly rebalancing periods, the portfolio had an annualized return of 14.9% versus the 12.1% for the market. This 2.6% annual outperformance versus the S&P 500 is shown in the charts below.



Even though interest rates have risen from the lows of last year, the price of money has been persistently lower in this economic cycle than it has been in the past. This factor continues to provide support for income-yielding stocks as many investors, including the growing population of retirees, are seeking more stable, fixed income-like returns. The risk of this strategy is that valuations for many companies, including higher dividend payers, have expanded much more than normal, and is reminiscent of the "Nifty-Fifty" period in the late 1970's. While investing in dividend yielding stocks certainly provides an additional return to portfolios, **as "GE" should have reminded you, stocks are "not safe" investments.** They can, and will lose value, and often much more than you can withstand. **This is why for our "safe money" we continue to use rallies in interest rates to buy bonds which provide both higher rates of income and safety of principal.**

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With valuation and safety being a top concern for investors, especially with [markets signaling more troubling technical trends](#), we continue to believe that the best way for investors to generate capital is to invest in quality businesses trading at a reasonable discount to their intrinsic value. As such, we focus on names which still maintain a reasonable valuation, are consistently growing, and are well founded in their industries. We think these names are more likely to offer investors both the yield they are looking for and are currently trading at prices that provide a reasonable margin of safety.

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