



# Reasons to Consider Dividend-Paying Stocks

By  
Fayez Sarofim & Co.

May 2014

## Reasons to Consider Dividend-Paying Stocks

1. Generate Income in a Low Yield Environment
2. Realize Potential for Dividends to Grow
3. Buffer Against Volatility While Outperforming Over Time
4. Provide Potential Source of Total Return/Capital Appreciation

### EXECUTIVE SUMMARY

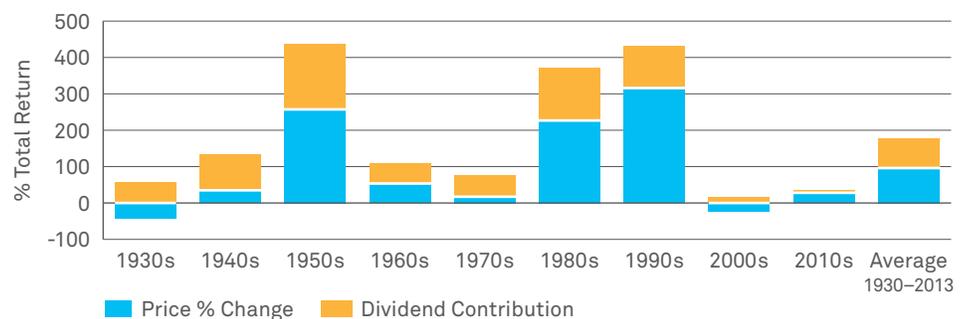
Dividends and the companies that pay them are attractive to advisors and investors alike because of their potential to provide a predictable source of current income, buffer market volatility and offer the potential for capital appreciation. As bond yields have fallen over the past decade, many traditional sources of investment income have become less attractive to investors looking for income. Dividend-paying stocks possess the attributes sought after during a volatile and uncertain marketplace as well as complement or supplement income from fixed income holdings. Furthermore, in addition to paying investors cash to hold their shares, dividend-paying stocks also offer features, in general, such as favorable tax treatment, a potential hedge against inflation and a source of portfolio diversification.

### A HISTORICAL PERSPECTIVE

History has shown that dividends have often been a powerful source of total return in a diversified investment portfolio. For decades, it was an accepted axiom of equity investing that dividends were an important component of total return. Since 1926, dividends have represented over 50% of the total market return. As seen in Exhibit A, dividend contribution to total return is heavily skewed towards the earlier decades, but, in our opinion, may be poised to regain its former prominence.

### Exhibit A. Through the Decades, Dividends Have Been A Significant Component of Total Return

S&P 500 Dividend Contribution\* to Total Return by Decade



Source: Strategas Research Partners, based on S&P 500, chained annual data.

\*Dividend Contribution represents the percentage of total return coming from dividends.

Data as of 12/31/13. **Past performance is no guarantee of future results.** These illustrations are based on the historical returns of the S&P 500 Index, a widely accepted, unmanaged index of U.S. stock market performance. Investors cannot invest in any index. Actual investment returns may vary. Data shown above is cumulative by decade. Dividend rates are not guaranteed payments, nor can they guarantee a rate of return.

---

Today's investors are looking for both a stable source of income and the potential for capital appreciation.

Beginning in the 1980s, dividends began to lose favor with investors during a period characterized by falling inflation and interest rates, an improving U.S. fiscal situation and a technological revolution. These positive factors unleashed a period of above average growth for U.S. corporations and the U.S. stock market. In the 1990s, as stocks were appreciating at average annual rates approaching 20%, the small contribution of a dividend yield seemed quaint and relatively unimportant in the scheme of total return. Furthermore, investors viewed companies that paid dividends as not having enough reinvestment opportunities for their excess capital and shunned them in this high growth environment.

As we fast forward to the present time, investors face a very different investment backdrop. Instead of benefiting from tailwinds, the U.S. economy has been slow to produce a sustainable recovery and to get its fiscal house in order. Global concerns figure prominently in the headlines whether it is European sovereign debt issues or sluggish global growth. Interest rates and inflation remain at historical lows, with little room to fall further, and the potential to rise dramatically. In the midst of this turbulent environment, a generation of baby boomers is beginning to retire and is seeking to secure adequate income for this next phase of life. When investors survey this current investment environment, their requirements for investments are very different from the 1980s, 1990s and even the 2000s. Many of today's investors are looking for both a stable source of income and the potential for capital appreciation — features that may be offered by a portfolio that includes dividend-paying stocks.

## **REASONS TO CONSIDER DIVIDEND-PAYING STOCKS**

### **1. Potential to Generate Income in a Low Yield Environment**

Of paramount concern to many investors today is how to generate income in the current low yielding environment. Unfortunately, for investors looking for a predictable source of income, many traditional sources such as U.S. Treasury securities or money market funds are not providing adequate yield to meet their needs. Dividend-paying stocks can serve as a complement to fixed income securities in order to provide a steady source of income to yield-hungry investors. In fact, a study showed that company management considered maintaining the dividend level as a priority on par with other management decisions, given the negative signal that cutting a dividend would send to the market regarding future growth prospects.\* However, unlike the interest income paid on most bonds, dividend payments on stocks are at the sole discretion of the company and are subject to change.

When the yield on the S&P 500 is competitive with other fixed income investments, albeit with a higher risk component, investors have an unusual opportunity to buy stocks that can potentially provide similar or even higher after-tax income than bonds, while seeking higher capital appreciation.

### **Favorable Tax Treatment of Dividend Income**

The current dividend and capital gains tax treatment was established with the American Taxpayer Relief Act of 2012 (ATRA). While the legislation increased the rate for those in the top income bracket, the rate at which dividends are taxed is less than prior to 2003 when dividends from stocks were taxed at ordinary income tax rates reaching as high as 38.6% for those in the top bracket. The legislation has maintained the rate at which certain stock dividends are taxed at a lower rate than ordinary income, making equity dividends potentially more attractive than debt income (which is taxed at an investor's marginal income tax rate) for tax purposes.

The tax information contained herein is general in nature and not intended to constitute tax advice. Please consult your tax advisor regarding your specific situation.

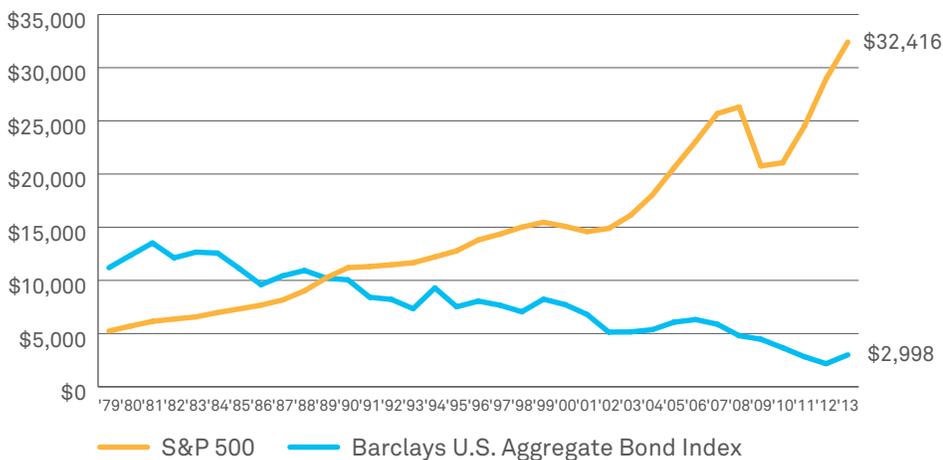
\*"Payout Policy in the 21st Century" study conducted in 2004 by Duke University, National Bureau of Economic Research, Cornell University and the Inter-Disciplinary Center (Israel).

## 2. Realize Potential for Dividends to Grow

When assessing dividend-paying stocks, it can be tempting to be interested in the highest dividend payers with the highest yields. However, choosing a stock based on high yield alone may lead investors to a company with no or low growth opportunities, or worse, one in distress. Careful research is necessary to understand a company's dividend policy and prospects. While there may be a place for these types of dividend payers in an income-oriented portfolio, we believe that companies with the potential to grow their dividend in the future, based on strong underlying profit growth, offer the additional prospect of an increasing income stream as well as greater potential for capital appreciation, based on profit growth. Initially, these stocks may offer a low or average yield, but if the company grows its earnings and management commits to raising its dividend, investors may receive a growing stream of income every year.

Many companies comprising the S&P 500 Index have a long history of increasing dividend payments. Exhibit B illustrates the growth in dividend income for the S&P 500 Index vs. interest income from the Barclays U.S. Aggregate Bond Index since 1979. The S&P 500's annual dividend income from a \$100,000 investment grew from \$5,234 to \$32,416 versus an actual decline in annual bond income received from the Barclays index over the same period.

**Exhibit B. Historically, Dividend Growth Outpaced Bond Income (1980–2013)**



Source: Fayed Sarofim & Co. Data as of 12/31/13. **Past performance is no guarantee of future results.** The Standard & Poor's 500 (S&P 500) Composite Stock Price Index is a widely accepted, unmanaged index of U.S. stock market performance. The Barclays U.S. Aggregate Bond Index is an index of the U.S. investment-grade fixed-rate bond market, including both government and corporate bonds. Investors cannot invest in any index. Actual investment returns may vary. Dividend rates are not guaranteed payments, nor can they guarantee a rate of return.

A company that can grow earnings and dividends at attractive rates over long periods of time can build a meaningful income stream. The S&P 500 Dividend Aristocrats index is a collection of these types of companies within the S&P 500 who have followed a policy of increasing dividends every year for at least 25 consecutive years. When an investor holds a stock for a long time frame, such as 25 years, a growing dividend becomes a significant value creator when compared to what was paid for the original shares, which can be measured by yield-on-cost. Yield-on-cost is the annual dividend of a stock divided by the average cost basis of the stock. Unlike current yield, which measures the yield of a stock relative to its current market

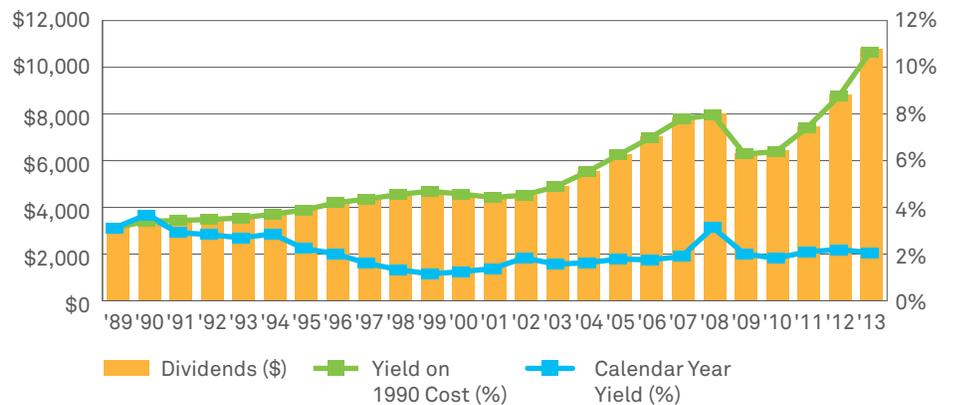
---

We believe that companies with the potential to grow their dividend in the future, based on strong underlying profit growth, offer the additional prospect of an increasing income stream as well as greater potential for capital appreciation, based on profit growth.

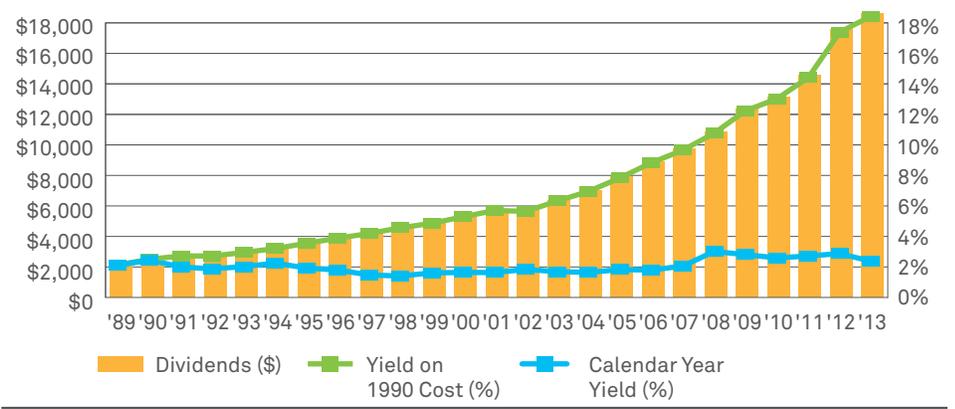
value, the yield-on-cost can help illustrate the annual return of the dividend on the original investment amount. Exhibit C shows the progress of the S&P 500's dividend payments as well as Dividend Growers (as measured by the S&P 500 Dividend Aristocrats). An initial \$10,000 hypothetical investment in 1989 (earliest period data available) would have a yield-on-cost at the end of 2013 of around 10.8%, but the yield-on-cost for the stocks represented by the Dividend Growers, as measured by the Dividend Aristocrats index, is around 18.6%. This statistic illustrates how a growing dividend adds value over time and contributes to the index's return. For example, the chart on the bottom shows the Dividend Grower's index portfolio paid \$1,863 in 2013, which is a 18.6% yield-on-cost (\$1,863 divided by the original investment of \$10,000). The current calendar year yield on the portfolio is 2.4%, reflecting the increased value of the portfolio since the time of purchase.

**Exhibit C. Historically, Dividends Have Added Long-Term Value Over Time**

Annual Dividend Growth on a One-Time Hypothetical \$10,000 Investment in S&P 500 vs. Yield



Annual Dividend Growth on a One-Time Hypothetical \$10,000 Investment in **Dividend Aristocrats** vs. Yield



Source: Strategas Research Partners. Data as of 12/31/13. The Standard & Poor's 500 (S&P 500) Composite Stock Price Index is a widely accepted, unmanaged index of U.S. stock market performance. **The S&P 500 Dividend Aristocrats index** tracks the performance of companies that have had an increase in dividends for 25 consecutive years. **Investors cannot invest in any index.** Actual investment returns may vary. Dividend rates are not guaranteed payments, nor can they guarantee a rate of return.

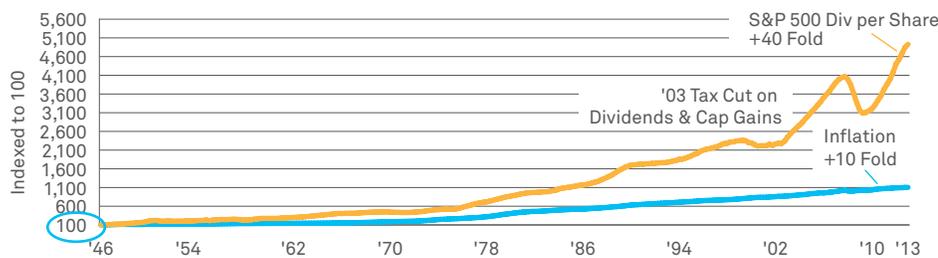
**Past performance is no guarantee of future results.** Yield-on-Cost is the annual dividend of a stock divided by the average cost basis of the stock. Unlike current yield, which measures the yield of a stock relative to its current market value, the yield-on-cost can help illustrate the annual return of the dividend on the original investment amount.

### Inflation Hedge — Growing Dividends May Help Investors Maintain Purchasing Power

Historically, owning stocks that regularly increase their dividend has proven to be a good hedge against inflation, especially compared to many bonds which offer a fixed income stream over the life of the bond. In an inflationary environment, holders of fixed income securities can face sharp losses in the value of their bonds because the interest payments are not growing in a period where prices are escalating; therefore the bond income's purchasing power may decrease over time. While there is no guarantee that companies will continue to maintain or increase their dividends, if a stock's dividend does grow at a rate equal to or faster than inflation, the loss of purchasing power can be prevented. Exhibit D shows that historically the dividend growth of the S&P 500 has outpaced that of inflation over the long term.

#### Exhibit D. Dividend Growth Rates Have Historically Outpaced the Inflation Rate

S&P 500 Annual Dividends per Share vs. U.S. Inflation Indexed to 100 on 12/31/46–12/31/13



Source: Strategas Research Partners.

**Past performance is no guarantee of future results.** The Standard & Poor's 500 (S&P 500) Composite Stock Price Index is a widely accepted, unmanaged index of U.S. stock market performance. Investors cannot invest in any index. Actual investment returns may vary. Dividend rates are not guaranteed payments, nor can they guarantee a rate of return.

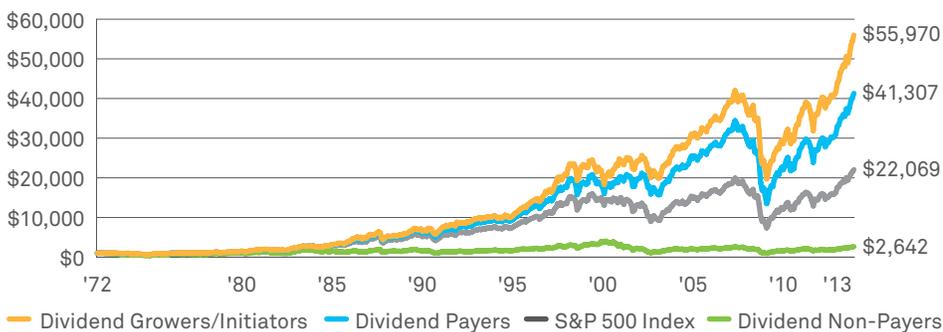
### 3. Potential Buffer Against Volatility While Outperforming Over Time

Dividend-paying stocks have historically provided some downside protection in volatile market environments. Dividend-paying stocks are typically companies that have a historical record of generating strong earnings and cash flow which gives them the financial strength to pay a dividend. Investors desire the stability of companies with a solid business model, while seeking to manage risk in a declining market. In addition, investors value the ability to receive an income stream in a turbulent market period.

Investors desire the stability of companies with solid businesses seeking to manage risk in a declining market.

#### Exhibit E. Historically, Dividend-Paying Stocks Outperformed and Were Less Volatile Over Time

Growth of \$1,000 invested in the S&P 500 Index by Dividend Policy 1/31/1972–12/31/2013



(continued)

ANNUALIZED RETURNS OF THE S&P 500 INDEX BY DIVIDEND POLICY (1/31/1972 THRU 12/31/13)

	Dividend Growers/Initiators	Dividend-Paying Stocks	Equal Weighted Index	Non-Dividend Paying Stocks
Annualized Return	10.07%	9.28%	7.64%	2.34%
Annualized Return/ Year in Bull Markets	23.02%	23.26%	22.61%	20.95%
Annualized Return/ Year in Bear Markets	-15.46%	-17.88%	-20.97%	-31.15%
Standard Deviation	16.12%	16.90%	17.85%	25.33%

Source: Copyright 2014 Ned Davis Research, Inc. (NDR) Further distribution prohibited without prior permission. All Rights Reserved.

**Past performance is no guarantee of future results.** Dividend rates are not guaranteed payments, nor can they guarantee a rate of return. Returns based on monthly equal-weighted geometric average of total return of S&P 500 component stocks, with components reconstituted monthly. **The Standard & Poor's 500 (S&P 500) Composite Stock Price Index** is a widely accepted, unmanaged index of U.S. stock market performance. **Dividend Paying and Non-Paying** dividend stocks are defined by each stock's dividend policy that is determined on a rolling 12-month basis. NDR classifies a stock as a dividend-paying stock if it pays a cash dividend any time during the previous 12 months. For instance, if a stock pays a dividend on July 1, it will be classified as a dividend-paying stock through June 30 of the following year. The index returns are calculated using monthly equal-weighted geometric averages of the total returns of all dividend-paying (or non-paying) stocks. A stock's return is only included during the period it is a component of the S&P 500 Index. The dividend figure used to categorize the stock is the company's indicated annual dividend, which may be different from the actual dividends paid in a particular month. **Dividend Growers/Initiators** is a subset of dividend-paying stocks and include stocks that increased their dividend anytime in the last 12 months. Once an increase occurs, it remains classified as a grower for 12 months or until another change in dividend policy. Investors cannot invest in any index. Actual investment returns may vary. **Standard deviation** is the statistical measure of the degree to which an individual value in a probability distribution tends to vary from the mean of the distribution.

#### 4. Provide Potential Source of Total Return/Capital Appreciation

As mentioned previously, dividends have historically represented a large portion of investors' total return. While that contribution waned in the 1980s and 1990s, in the period from 2000-2010 dividends provided a source of positive return as equity prices declined in this decade. As we rotate into the mid-2010s, continued favorable tax treatment and investors' increasing desire for income is influencing companies to place more emphasis on paying and raising their dividends. Furthermore, the payout ratio of the S&P 500, an indication of how much a company's profits are used to pay dividends, is very low by historical standards, giving many companies ample room to potentially raise their dividends without endangering their balance sheets or forgoing attractive investment opportunities. In a low nominal growth environment, dividends may compensate for lower price appreciation.

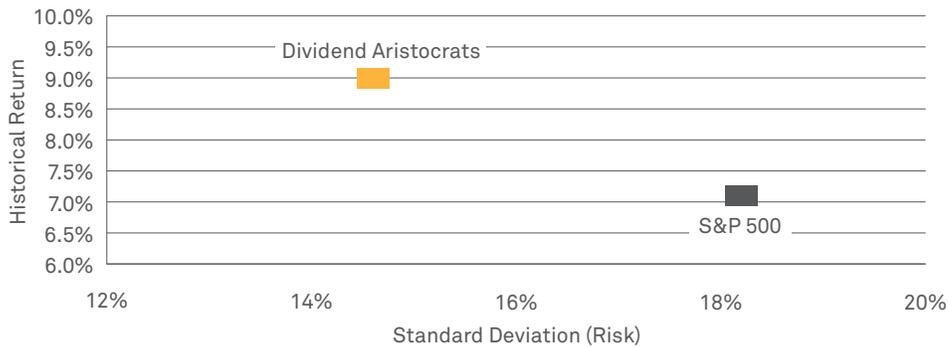
As the baby boom generation matures, many of these investors entering retirement are faced with inadequate savings to fund their retirement, particularly given the sub-par yields being offered in the bond market. While investing in stocks offers the prospect of both capital appreciation and depreciation, some investors should consider adding dividend-paying stocks to their asset allocation as both a source of income and as a means to potentially grow their capital. We believe because of dividend-paying stocks' attractive investment qualities, more of the baby boom generation shifting into retirement will increase demand for dividend-paying stocks over time.

Dividend-paying stocks are companies that have the earnings and cash flow emanating from a strong business model to make the commitment to pay dividends. We believe the payment of a dividend is a signal of a company's financial strength and confidence in its future growth prospects. Therefore, as seen in Exhibit F, it is not surprising that history has shown that companies that have consistently raised their dividend not only have outperformed the S&P 500 index, but have done so with less risk (volatility), as measured by standard deviation.

History has shown that companies that have consistently raised their dividend not only have outperformed the broader index, but have done so with less risk.

## Exhibit F. Historical Outperformance with Less Risk

S&P 500 vs. S&P 500 Dividend Aristocrats 1989 – 2013  
(Compound Annual Return vs. Standard Deviation)



Source: Strategas Research Partners.

**Past performance is no guarantee of future results.** The Standard & Poor's 500 (S&P 500) Composite Stock Price Index is a widely accepted, unmanaged index of U.S. stock market performance. The S&P 500 Dividend Aristocrats index tracks the performance of companies that have had an increase in dividends for 25 consecutive years. Investors cannot invest in any index. Actual investment returns may vary. Dividend rates are not guaranteed payments, nor can they guarantee a rate of return. **Standard deviation** is the statistical measure of the degree to which an individual value in a probability distribution tends to vary from the mean of the distribution.

## CONCLUSION

We think a portfolio containing dividend-paying stocks has become more attractive as more investors desire income with the potential for growth in income and capital appreciation. A diversified portfolio that contains these stocks can provide a source of income diversification from the bond market while also potentially offering more favorable tax treatment (versus a bond) and lower equity volatility (than the broader equity market).

However, when seeking to create a diversified portfolio that includes dividend-paying stocks, we think it is necessary to go beyond a market index fund or a basket of only high-yielding stocks. While a market index fund will offer some yield, typically the index includes many low- or non-yielding stocks. Conversely, a basket of only high yielding stocks may unintentionally lead an investor to hold companies with low growth prospects or unsustainable dividend levels. We believe an investment manager who can look beyond the superficial statistics and understand a company's financial position and growth prospects is necessary when trying to successfully identify and create a portfolio of potential dividend payers and growers. In addition to seeking an acceptable level of current income, the manager can strive to identify companies that have strong growth prospects and which have the potential not only to preserve, but also to raise the dividend on a regular basis.

At Fayez Sarofim & Co., our firm's time-tested investment philosophy has always centered on identifying industry leading companies with financial strength and strong growth prospects in structurally attractive industries. The companies that meet our investment criteria typically produce strong earnings and cash flow which can be used to fund dividend payments to investors. Our in-depth research process and focus on company fundamentals help us identify companies who not only pay dividends but also are likely to have the capability to raise them on an ongoing basis. Furthermore, our research process includes meetings with company management and an assessment of their dedication to maintain and increase the dividend over time. We believe the Sarofim investment approach can provide exposure to dividend-paying stocks, with an emphasis on dividend growers, while maintaining the long-term potential for capital appreciation.

---

We believe an investment manager's skill of looking beyond the superficial statistics and understanding a company's financial position and growth prospects is necessary when trying to successfully identify and create a portfolio of potential dividend payers and growers.

## LEARN MORE

**Mutual Fund Investors:** Contact your financial advisor or visit [dreyfus.com](http://dreyfus.com)  
**Advisors:** Call 1-800-334-6899 or visit [dreyfus.com](http://dreyfus.com)

**Investors should consider the investment objectives, risks, charges, and expenses of the fund carefully before investing. Contact your financial advisor to obtain a prospectus, or a summary prospectus, if available, that contains this and other information about the fund, and read it carefully before investing.**

The statements and opinions expressed in this article are those of the authors as of the date of the article, are subject to change as economic and market conditions dictate, and do not necessarily represent the views of BNY Mellon, or any of their respective affiliates. This article does not constitute investment advice, is not predictive of future performance, and should not be construed as an offer to sell or a solicitation to buy any security or make an offer where otherwise unlawful. BNY Mellon and its affiliates are not responsible for any subsequent investment advice given based on the information supplied.

**Past performance is not a guide to future performance.** The value of investments and the income from them is not guaranteed and can fall as well as rise due to stock market and currency movements. When you sell your investment you may get back less than you originally invested.

Products or services described in this document are provided by BNY Mellon, its subsidiaries, affiliates or related companies and may be provided in various countries by one or more of these companies where authorized and regulated as required within each jurisdiction. However, this material is not intended, and should not be construed, as an offer or solicitation of services or products or an endorsement thereof in any jurisdiction or in any circumstance that is otherwise unlawful or unauthorized. The investment products and services mentioned here are not insured by the FDIC (or any other state or federal agency), are not deposits of or guaranteed by any bank, and may lose value.

BNY Mellon Investment Management is one of the world's leading investment management organizations and one of the top U.S. wealth managers, encompassing BNY Mellon's affiliated investment firms, wealth management services and global distribution companies. BNY Mellon is the corporate brand of The Bank of New York Mellon Corporation. The Dreyfus Corporation and MBSC Securities Corporation are subsidiaries of BNY Mellon. MBSC Securities Corporation, a registered broker-dealer and FINRA member, is the distributor for the Dreyfus Funds.

Fayez Sarofim & Co., sub-investment adviser to a range of Dreyfus-managed funds, was founded in 1958 to provide investment counseling services and has remained focused exclusively on this one business. Fayez Sarofim & Co. is not affiliated with Dreyfus or BNY Mellon.

---

### MAIN RISKS

Dividend rates are not guaranteed payments, nor can they guarantee a rate of return.

Equity funds are subject generally to market, market sector, market liquidity, issuer, and investment style risks, among other factors, to varying degrees, all of which are more fully described in the fund's prospectus.

Investing internationally involves special risks, including changes in currency exchange rates, political, economic, and social instability, a lack of comprehensive company information, differing auditing and legal standards, and less market liquidity. These risks generally are greater with emerging market countries than with more economically and politically established foreign countries.

Asset allocation and diversification do not ensure a profit or guarantee against loss.

