Focus on Quality, Not Higher Yields

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When focusing on dividend-paying stocks for income, we believe you should avoid searching for the highest-yielding companies. Instead, look for higher-quality stocks with the potential to grow their dividends over time. Higher yield is usually associated with higher risk, and these stocks may fall short of expectations because of dividend cuts, lower growth in earnings and dividends, or negative effects from rising long-term interest rates.

What Is Yield?
The dollar amount of dividends paid in a year relative to the share price. The dividend yield is expressed as a percentage.

Many investors wisely look at dividend-paying stocks as complementary income-producing vehicles to other asset classes, such as fixed-income investments. However, in their search for additional income, some investors are focusing on the highest-yielding stocks, which we believe carry additional income-reducing risks. These stocks also have tended to underperform the market despite having very high dividend yields. We recommend owning higher-quality, dividend-paying stocks that have the potential to grow their dividends over time.

High-yield Stocks Typically Carry Higher Risk
High yields can be the market’s signal that investors have concerns. If the market is pricing a stock at a level where the yield is unusually high, it may be signaling one or more of the following:
• The dividend is increasingly at risk and could be cut.
• Growth prospects or business fundamentals at the company have deteriorated, and future dividend increases are unlikely.
• The level of income isn’t quite what it appears to be. With certain types of investments (such as master limited partnerships), some of the income ends up reducing your cost basis and may potentially result in your having to pay more taxes when you sell the stock.

The Effect of Rising Rates
If the U.S. economy continues to recover and the Federal Reserve gradually tightens monetary policy, the resulting expected rise in long-term interest rates would likely have a significant effect on higher-yielding stocks. When long-term interest rates rise, dividend yields tend to rise too mostly due to the share price declining. Higher-yield stocks will likely underperform the stock market as long-term rates rise.
Rising Income and Total Return Matter

It's important to focus on your total return from owning stocks and the potential for rising income, not just the current dividend income. Total return includes share price appreciation and dividend income over time. In addition, a primary reason for owning dividend-paying stocks is the opportunity for rising income, whether reinvested or used to pay for everyday living. If the dividend is not growing, an investor's inflation-adjusted income from the stock actually declines over time.

Higher-quality companies that grow their dividends over time can provide a rising stream of current income that helps offset inflation. Historically, these stocks have delivered a higher total return for investors.

Focus on Higher-quality Dividend Growers

Companies that pay and grow their dividends over time have historically offered several benefits, including:

• Rising income potential to help offset inflation – A potentially growing stream of dividend income can help offset rising prices over time.

• Quarterly or monthly income – While most companies pay dividends quarterly, you can receive monthly income by staggering your stocks’ dividend payment dates. Our Edward Jones Monthly Income Plan can help accomplish this.

• Total return potential – Historically, dividend payments have been an important part of the total return from stocks. Since 1950, dividends (with reinvestment) have accounted for approximately 90% of the total return of stocks, according to Bloomberg, and we expect growing dividends to continue to play an important role in stock returns.

• Track record of good performance – Dividend-paying stocks have performed well over long periods of time and have dramatically outperformed the highest-yielding stocks and those that don’t pay a dividend. In addition, stocks in companies that have been able to grow their dividends have outperformed stocks that pay a dividend but have not been able to grow it (see chart).

• Likely less sensitive to rising interest rates – Stocks with more moderate yields and rising dividends should be less affected by the rise in long-term interest rates than stocks with high yields and low growth.

Check Out the Equity Income Buy List

A good place to start when looking for dividend-paying stocks is the Edward Jones Equity Income Buy List, a list of Buy-rated stocks that on average offer dividend yields greater than 3% – well above the market yield near 2%. Most of these stocks also offer above-average dividend growth potential, good historical dividend growth and attractive prices.

Actions for Investors: Add Rising Income Today

We believe now is an especially compelling time to consider rising-income stocks for your portfolio, including those on the Edward Jones Equity Income Buy List. Take this opportunity to talk with your financial advisor about appropriate ways to include rising income as part of your overall portfolio.

*Past performance is not a guarantee of future results.

Diversification does not guarantee a profit or protect against loss. Dividends can be increased, decreased or eliminated at any point without notice. Before investing in equities, you should consider the risks involved, including loss of principal. Share prices will fluctuate with changing market conditions, and performance is not guaranteed.

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