Dividends back in style as demand for yield rises: Merrill Lynch strategist offers list of 18 best U.S. bets

National Post
Saturday, October 8, 2005
Page: FP10
Section: Financial Post Investing
Byline: David Berman
Column: This Week in the Markets
Source: Financial Post
Idnumber: 200510080156
Edition: National
Story Type: Business; Column
Note: dberman@nationalpost.com.
Length: 572 words
Keywords: FOREIGN EXCHANGE; STOCK MARKET; STATISTICS
Illustration Type: T
Illustration: Table: Merrill Lynch

National Post / BERNSTEIN'S TOP PICKS: High quality and dividend yield screen.: (See print copy for complete table.)

Given the wonky state of the income trust sector, which has been in a multi-billion dollar swoon since mid-September, the once-ignored dividend-paying stock is starting to look a lot more attractive.

The reason? Some investors are convinced that the federal government will attempt to discourage new income trusts -- which pay out most of their free cash flow to investors because of the tax advantages -- by reducing the taxes paid on dividends.

That way, Canadian companies would have an incentive to remain in their current corporate structure and may have a good reason to increase their dividends as well.

If the change occurs, you can expect Canada's dividend landscape to get decidedly more interesting. More people would be talking about dividends, analyzing dividends and investing in dividends. At the same time, more funds and even ETFs would be devoted to dividend-paying stocks.

In the United States, dividends already receive a ton of attention. Analysts routinely slice and dice numbers on which companies are likely to raise their dividends. The information and analysis of dividends is deep in part because the U.S. market is so huge and the choice of dividend stocks so broad. But U.S. investors who want a steady stream of cash distributions also don't have income trusts in which to invest. Perhaps more important, dividends are taxed favourably in the United States following a big tax cut in 2003.

Richard Bernstein, the U.S. strategist at Merrill Lynch who has been recommending investors take a more cautious approach to U.S. equities, produced a research note last week that focussed on dividends. He sifted through data on 1,600 companies to come up with a select list of 18 that offered the safest yields.

"There are plenty of growth stories in the equity market these days, but there remains a scarcity of 'safe' dividend yield," Mr. Bernstein said in his research note to clients. "This scarcity comes at a time in which the demand for yield and income should begin to increase because baby-boomers are aging."

According to the strategist, "safe" means that Standard & Poor's has given the common stocks a high ranking, based on stability of earnings and dividends over the past 10 years. From here, Mr. Bernstein looked for stocks that had a greater dividend yield and return on equity than the S&P 500 average. They also had to have a below-average debt-to-equity ratio.

His findings? Based on dividend yield, Conagra Foods Inc. (CAG/NYSE) came out on top, with a 4.4% yield. Altria Group Inc. (MO/NYSE), Ingersoll-Rand Corp. (IR/NYSE), Kimberly-Clarke Corp. (KMB/NYSE) and General Mills Inc. (GIS/NYSE) rounded out the top five.

"Despite that low quality stocks have recently outperformed, we continue to believe that investors should overweight higher quality assets with high dividend yield because the profits cycle is decelerating, the Fed is raising rates and the yield curve is flatter than normal," Mr. Bernstein said.

Rather than buying individual stocks, investors can also cast a wide net with the purchase of an exchange traded fund (ETF) that specializes in U.S. dividend-paying stocks. For example, the iShares DJ Select Dividend index fund (DVY/NYSE) gives investors exposure to 100 stocks that comprise the Dow Jones Select Dividend index.

No matter what Ottawa does with income trusts, Canadians are going to be demanding more research and variety of dividend-based investments as the bulk of the Boomer population heads into retirement. Ottawa's decision on trusts can only speed up this demand.