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Build a portfolio that pays dividends

With yields at highest levels in years, dividend-paying stocks are attractive

By Andrew Leckey
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Dividend yields have rarely looked better, if you're careful to select shares of companies strong enough to avoid having to cut their payouts.

Even though a large number of dividends have been cut or eliminated in recent months, the market downturn also presents possibilities, experts said.

The Standard & Poor's 500 stock index is yielding around 3 percent, the highest level for those stocks since 1991. In addition, the S&P is providing a yield higher than the 10-year Treasury bond for the first time since 1958.

A dividend yield is calculated by taking the annual dividend per share and dividing it by the stock price. For example, a $1.50 annual dividend for a $25 stock represents a 6 percent yield.

"Dividend yields on quality stocks are now at levels I haven't seen in more than 15 years," said **Charles Carlson, editor of the DRIP Investor newsletter in Hammond**. "The market decline in 2008 was so broad-based that it took down most stocks, and, as a result, many stocks you don't think of as dividend stocks have pretty good yields."

Quality is key. Who wants a high dividend that lasts only a month or two before being slashed or eliminated?

"You can't select by highest dividend yield because that will lead you to stocks with a higher risk of that dividend being cut," said Richard Cripps, chief market strategist for Stifel Nicolaus in Baltimore. "The financial sector cut all its dividends to the point where it can't cut anymore, and we're probably through the worst for most other companies, but some retailers may need to cut because Christmas sales were so bad."

With bank dividends no longer the centerpiece of income investing, new choices have emerged.

Intel Corp., the world's largest semiconductor company, historically was not a stock that investors would look to for a good dividend. Many technology stocks don't pay dividends.

But now, with a healthy dividend yield of more than 4 percent, Intel is recommended by both Carlson and Cripps. It is a solid, well-financed company with lots of cash, virtually no debt and a dividend considered to be safe. It remains in the forefront of technology through its extensive research and development, while holding three-fourths of the microprocessor market.

"Dividend yields have definitely been shooting up, making this one of the best times to buy dividend-paying stocks," said Josh Peters, editor of the Morningstar Dividend Investor newsletter in Chicago.

"Whatever the near-term future will be for stock prices, you can get really good cash returns on investments right away through dividends."

Don't overlook traditional possibilities, Peters said.

AGL Resources Inc., a natural gas company with regulated distribution in Florida, Georgia, Maryland, New Jersey, Tennessee and Virginia, is a "boring but steady" dividend-paying utility, he said. Its stock has a yield around 5.5 percent.

AGL is one of the most profitable companies in its industry, with excellent cost management and sound financial health. The stock also should be steady in comparison with volatility of many others.

Emerson Electric Co., an electronics and electrical equipment firm with dividend yield of 4 percent, is a Carlson choice because it has raised its dividend for each of the past 52 years.

"The competition from other investments is lousy if you're an income investor," Carlson said. "While investors are willing to accept a half-percent or 1 percent yield on their money market in order to trade return for safety when stocks are plummeting, at some point they realize no one is going to get rich off a 1 percent return."

Microsoft Corp., with a yield of nearly 3 percent and no debt, is another recommendation from Cripps. Kimberly-Clark Corp., the global health and hygiene company, with a yield around 4.5 percent, is a consumer staple stock with a safe dividend, he said. Reliability is crucial.

"A very good company that has a dividend yield of just 2 or 3 percent might not sound like much," Cripps said. "However, if it has been consistent with its dividend over many years, that says something."

McCormick & Co., with a yield around 3 percent and a market share in branded spices of 50 percent, is recommended by Peters. Huge financial disasters or cyclical downturns don't frequently occur in the spice business, he said.

"What makes dividends attractive in good times makes them incredibly attractive in really bad times," said Peters, who said it is nearly impossible to find a company that won't have an earnings decline in 2009. "Dividends allow you to bypass what's going on with the stock price day to day and earn cash directly from the underlying business."

An exchange-traded fund focusing on dividend stocks is the SPDR S&P Dividend ETF. It tracks the S&P High Yield Dividend Aristocrats index of the 50 highest-yielding stocks on the S&P 1500 index that have increased their dividend payouts for the past 25 years.

But that ETF suffered a 26 percent decline last year, largely because one-third of its portfolio was in financials. That is why some experts consider picking individual stocks to be a better dividend strategy.

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