Investing In 2018: Dividend Stocks

As of this writing, it appears that 2018 may be a difficult year for investors. Yields on bonds, bank accounts, money market funds, and other savings vehicles are extremely low, with questionable prospects for substantial increases. Stock market indexes, on the other hand, are at or near record levels.

In essence, relatively low-risk places to put your money this year appear to offer scant returns. Equity markets have been rising since early 2009, so the chance of a pullback may be just as great as the possibility of solid gains.

Given this environment, where might investors go for opportunities for respectable returns with some protection against a steep decline? One possibility is in the stock market.

Paying Dividends

Equity markets are notoriously difficult to predict. Nevertheless, dividend paying stocks might tilt the risk-reward odds in your favor. During recent bear markets, dividend payers generally fared better than those that didn't pay dividends.

This seems reasonable because dividend paying companies may be enterprises that generate ample cash flow—enough to distribute some profits to investors. Companies in strong financial condition could be favored by investors in stormy economic weather, and the prospect of ongoing dividend payouts might stem panicked selling.

Floor and Ceiling

Whereas dividend paying stocks may offer some protection during down markets, they also might deliver solid returns. The yield on the benchmark Standard & Poor's 500 Index currently is nearly 2%. That's the yield for the broad index, so some of the large companies included in the index have dividend yields of 3% or more. When an investment starts with such a payout, it's less likely to fall into negative territory and is already on the way to possible robust returns.

Dividends can grow, too. Indeed, many public companies have long histories of raising their payouts.

Example: Nancy King is a widow who depends on investment income for her lifestyle. She invests $50,000 in shares of GHI Corp., currently paying a 4% dividend, or $2,000 a year. If GHI raises its annual dividend to $2,500 over the next few years, Nancy will collect a 5% return on her initial investment.

In addition, *qualified dividends* (see **Trusted Advice** box) receive favorable tax treatment. Nancy, in a low tax bracket in our example, could owe 0% on qualified dividends. Other taxpayers owe 15% or, for those in the highest ordinary tax bracket, 20%. These rates are lower than ordinary income tax rates.

Go with a Pro

It's true that dividend paying stocks can offer many advantages. However, investing in equities carries risks; even the most established company, with excellent management, can see its share price tumble in a broad selloff. Selecting individual dividend paying stocks can require thorough research and portfolio monitoring.

Therefore, many investors prefer to invest in mutual funds or ETFs that focus on dividend stocks. There are dozens of such funds available, with portfolio managers who are responsible for stock selection. Other funds track a custom index of dividend paying stocks. Dividend stock funds tend to fall into two broad categories:

- **High payout.** Some funds are designed to pay higher yields than the S&P 500, perhaps 3% or 4%. They may use "dividend capture" strategies, buying funds just before a dividend payout. High dividends may be appealing, but a robust payout can indicate a relatively low share price due to concerns about the company's growth prospects.
- **Dividend growth.** These funds may have yields similar to the S&P 500 or lower. However, the stocks they hold are chosen because the companies have enjoyed growing earnings along with rising dividends and are considered likely to continue such profitability.

Quality Counts

Dividend oriented investors may hold individual stocks, specialized funds, or a combination. They aim to own successful, profitable companies that will provide a steady stream of cash flow, bull market or bad. There's no magic about dividend paying stocks and there have been instances in which a dividend cut has been followed by a plunging stock price. Still, buying successful companies that pay appealing dividends is one way to approach equity investing this year, with current prices at lofty levels.

Trusted Advice

Qualified Dividends

- Most stock dividends paid to U.S. investors are qualified dividends that are subject to the low 0%, 15%, and 20% tax rates.
- To be qualified dividends, the dividends must be paid by a domestic corporation or a foreign corporation that meets certain requirements (a qualified foreign corporation).
- To get the low rates, investors must hold onto a stock for more than 60 days during the 121 day period, which begins 60 days before the ex dividend date.
- The ex-dividend date is the first day of trading when the buyer of a stock is no longer entitled to the most recently announced dividend payment. If the ex-dividend date is December 12, a December 11 buyer would receive the latest dividend, but a December 12 buyer would not receive it.