

A Better

Dividend Investing

Strategy:

High Yield 

or Low Yield?

We all dream of retiring with a steady, passive income. Investing in dividend stocks is one of the popular ways to achieve this. Imagine receiving your dividend pay check every year, regardless of whether the markets go up or down! Conventionally, dividend investors will go for high dividend yield stocks to boost their income immediately. However, is a stock with 10% dividend yield better than one with 3% in the long run? Does a high yield stock always outperform a low yield stock?

Let's compare the performance of two investors. Investor A invested in ABC Company which pays 10% dividend yield every year while investor B invested in XYZ Company which pays 3% yield. The pay out of the XYZ Company is lower, but the company reinvests some of the earnings in their business and grows their dividend pay-out by 10% every year (e.g. \$0.03 dividend per share in year 1, \$0.033 in year 2...). Assuming the share prices for both of the companies remains unchanged for 25 years and both investors reinvested their dividends every year. Their performance can be found in Table 1.

Investor A, the high yield investor, beats Investor B during the beginning years. The dividend pay-out

Year	Investor A		Investor B	
	Portfolio(\$)	Dividends(\$)	Portfolio(\$)	Dividends(\$)
1	10000	1000	10000	300
2	11000	1100	10300	340
3	12100	1210	10640	386
4	13310	1331	11026	440
5	14641	1464	11466	504
6	16105	1611	11970	578
7	17716	1772	12548	667
8	19487	1949	13215	773
9	21436	2144	13988	900
10	23579	2358	14887	1053
11	25937	2594	15941	1240
12	28531	2853	17181	1471
13	31384	3138	18651	1756
14	34523	3452	20408	2114
15	37975	3797	22521	2566
16	41772	4177	25087	3144
17	45950	4595	28231	3892
18	50545	5054	32122	4871
19	55599	5560	36993	6170
20	61159	6116	43163	7919
21	67275	6727	51083	10310
22	74002	7400	61393	13630
23	81403	8140	75022	18321
24	89543	8954	93343	25075
25	98497	9850	118418	34992

Table 1

and portfolio value of Investor B caught up in year 19 and 24 respectively. The total dividends received by Investor B are more than 3 times that of Investor A. Investor B received low pay-out initially but was rewarded with future growth. This is the underlying principle of the dividend growth investing strategy. Companies with a high dividend yield compared to the market average could be having some financial difficulties. The high dividend yield could be the result of declining share price due to fundamental problems such as inconsistent earnings, high valuation, high debt etc. Besides, high dividend yield is often not sustainable. If earnings fall, the management may cut the dividends or eliminate the pay-out altogether.

INTERESTING FACT

Warren Buffett who is well known for picking value and growth stocks also invests in dividend stocks. More than 90% of the companies in his portfolio pay dividends and most of these companies have been growing their dividends over a decade.

strategies' performance with the Straits Times Index.

Three criteria:

- Dividend yield > 3%
- Dividend growth rate 5 year average > 8%
- Market Capitalization > \$200M

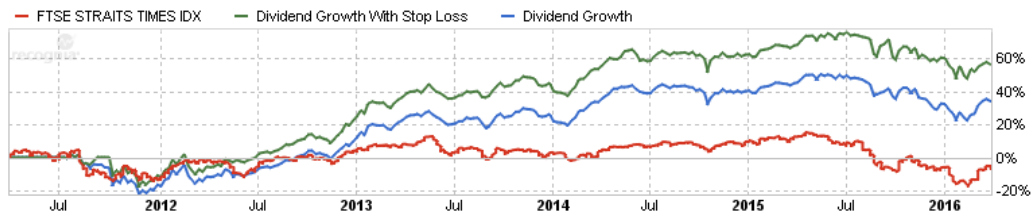
If you started investing using this strategy five years ago and rebalanced your portfolio every three months, you would have made 34.1% (excluding dividends) as compared to -8.8% on STI index (Refer to Figure 1).

By tweaking the strategy with Recognia's built-in trailing stop, the returns were improved to 56.3%. There are currently 22 stocks that fulfil the criteria above (as of 30 March 2016).

Screening the market using the dividend growth strategy.

Using the Singapore stock market as an example, we have come up with three simple criteria and back-tested the strategy using Recognia Strategy Builder™ available on our KE Trade platform, to compare our

Investing in dividend growth stocks is one of the many strategies that could help you to generate sustainable passive income for long term investment. This article illustrated a simple concept to screen for dividend growth stocks, but this is by no means the perfect strategy for picking dividend stocks.



Action	Screen Name	Annualized Return	5 Year Return	3 Year Return	1 Year Return	6 Month Return	Avg. # Results
	Dividend Growth With Stop Loss	9.3%	56.3%	14.6%	-6.7%	-2.9%	7.9
	Compare To:	-1.8%	-8.8%	-13.9%	-17.5%	0.5%	--
	<input type="text" value="Straits Times Index"/>						
Previous Versions of this Screen							
	Dividend Growth	6.1%	34.1%	9.5%	-7.3%	-2.1%	8.4

Figure 1