Investing In Canadian Dividend Stocks
(Part 1)

By David Stanley

Dale Ennis, the editor of the *Canadian MoneySaver*, asked me to share my approach to investing with you.

My basic message for Canadian individual investors is quite simple:

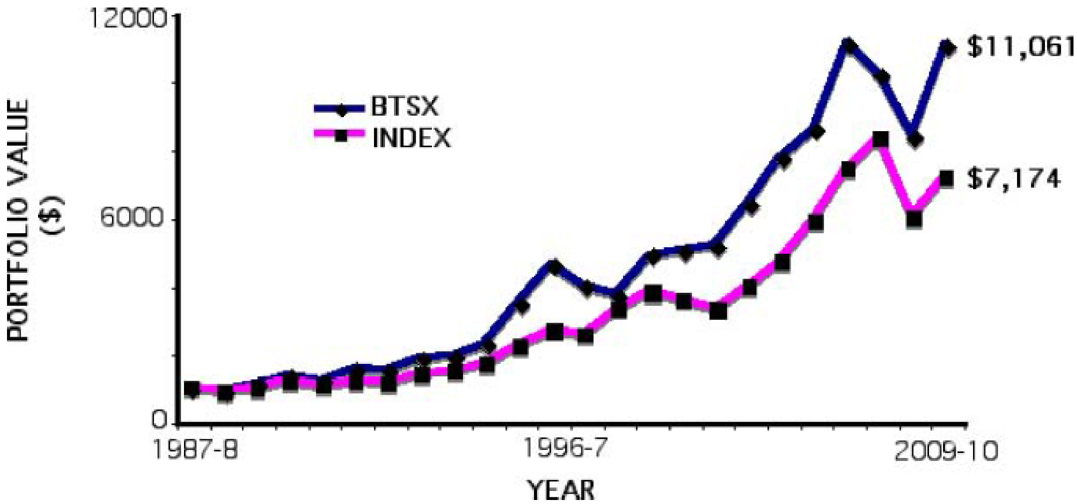
1. Almost everyone can take charge of their own finances and outperform stock mutual funds. All it takes is a little courage and patience.
2. Gaining knowledge about how to invest is the first step to your empowerment.
3. Most investors are best served by a simple investment plan that stresses Canadian blue-chip, dividend-paying common stocks.

These articles are meant to be short and to the point, so I don't have the space to tell you about my background and how I came to dividend investing. But, you can to see how my investment philosophy evolved by downloading the "Beating the TSX" report (complimentary) at http://www.canadianmoneysaver.ca/tt_moneys.aspx. Please note that you must be a registered *MoneySaver* member to view this report. What is of more immediate concern is if this method is right for you and what it has produced in the past.

First, I consider myself quite a conservative investor. That means I don't think anyone should be putting money into the stock market if they are paying off high-interest obligations like credit card debt. Also, it makes sense for most Canadians to make maximum contributions to a tax-free or tax-deferred savings plan (TFSA/RRSP). If, when these stipulations are met, you still have funds that you won't need for five to ten years, you think you can stomach the daily ups and downs of market volatility, and you are willing to spend some time learning a few basics, then you are ready to begin a process that allows you to avoid the high cost of mutual funds and take control of your own investments.

Now, a very simple description of the method I use is to select the top ten yielding stocks from an index of Canadian blue-chip companies. Currently we are using the S&P/TSX 60 Index that contains the 60 largest companies by market capitalization (the number of shares outstanding multiplied by the current price of a share) listed on the Toronto Stock Exchange. These stocks are held for one year and then the process is repeated. To understand the process in more detail you can read the BTSX report on this site or see if your library has the book *Beating The Dow* by Michael O'Higgins. This is a very easy and quick approach to dividend investing, but how has it performed?

The accompanying graph shows the value of a $1000 investment made in 1987 (the year I began "Beating The TSX" [BTSX]) in either the dividend portfolio or the index through 2009. The dividend portfolio has outperformed the index by 54% for this time and was successful in both up and down markets. Over this 23-year period the portfolio recorded an average gain of 12.57% yearly versus 10.15% for the index. It is interesting to note that for the same period the S&P/TSX 300 Composite Index, containing 300 companies, has averaged only a 4.43% yearly increase. This shows two things: first, blue-chip companies that pay dividends outperform smaller companies that don't; second, selecting the highest dividend payers from the blue-chip index gives investors an extra boost in returns. We can conclude that dividends are very important in investing, even more than capital gains over time. The current dividend yield on our portfolio is 4.72%, about twice that of the S&P/TSX 60 Index. You can compare these numbers with the yields on fixed-income investments like bonds or GICs or what the bank is paying you now on your savings account.



Why are dividends so important to our returns? Here is a rather long list that only covers the major points:

- In my opinion, the single most important aspect of dividends for the individual Canadian investor is the opportunity it provides for compounding. Simply, compounding is the ability of an investment to generate returns that are then reinvested so as to generate their own added returns. The success of any dividend compounding strategy depends upon the dividend level, the cost of reinvestment, and, of most importance, the time over which compounding is allowed to work.
- Canadian investors have the opportunity when investing in certain companies to take advantage of Dividend Reinvestment Plans (DRIPs) and Stock Purchase Plans (SPPs). The plans allow for the low- or no-cost reinvestment of dividends into new shares, and the cash purchase of new shares with no commission fees. While not all companies offer these plans, they are common with high-yielding stocks. For example, in this year's portfolio seven of the ten companies have both DRIPs and SPPs.
- An important aspect of investing is to minimize taxes. Dividends are taxed at a lower rate, if outside a registered plan, than interest income. So, for the previous tax year an Ontario taxpayer with an ordinary income level of about $65,000, a dividend yield of 5.0% would equate to an interest return of about 6.9%.

- If the financial pundits are correct and we are entering a period of higher inflation and stagnant stock prices, dividend investing has the potential to continue to outperform the general market. Many studies have shown that over long periods of time at least half of the total returns from equity investing comes from dividends. This proportion will increase in a sideways stock market. Also, dividend stocks perform better in a down market than non-dividend stocks since, when the prices drop, buyers rush in to purchase them for the dividend stream alone. This was amply demonstrated during the recent (an ongoing?) recession.
- A dividend stream can be very rewarding to retirees since, over time, dividends tend to increase whereas payments from fixed-income investments are just that, fixed. There is something very satisfying about opening an envelope containing a dividend cheque.

I hope you find this information useful and if you have questions please pass them along to Dale Ennis at the *MoneySaver* who will forward them to me. Next time we will discuss how you can get started investing in dividends.

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