EXPERIENCED AND INDEPENDENT ADVISORS WORKING PRIMARILY WITH ACCREDITED ENGINEERS, EXECUTIVES, AND ENTREPRENEURS

SARVER VROOMAN
WEALTH ADVISORS

9237 Ward Parkway, Suite 320 | Kansas City, MO 64114

from left: **Ron Dietz, CPWA®, CIMA®,** Partner, Wealth Advisor; **Kat Aguilar,** Operations Specialist; **Jonathan Sarver, CPWA®,** Managing Partner, Wealth Advisor; **Jessica Estes, MBA,** Operations Manager; **Peter Vrooman, CFA®, CIMA®, CRPC®, CAIA®,** Managing Partner, Wealth Advisor; **Thomas King, MS in Finance,** Partner, Wealth Advisor

Three Compelling Reasons to Invest in Dividend Paying Stocks

Introduction

This white paper will discuss three key reasons why investors should consider dividend-paying stocks as an integral part of their investment strategy. Dividend payments have long been favored by investors seeking a consistent income stream while also aiming for long-term capital appreciation. Through an exploration of the benefits and advantages of dividend-paying stocks, this paper aims to provide valuable insights for investors looking to optimize their portfolios.

1. Steady Income Stream

One of the primary reasons to invest in dividend-paying stocks is the opportunity to generate a consistent income stream. Dividend payments are typically distributed on a regular basis, often quarterly, by companies that have a history of profitability and a commitment to returning a portion of their earnings to shareholders. This consistent flow of income can be particularly attractive for investors seeking stability, such as retirees or individuals looking to supplement their regular income.

a. Cash Flow Stability: Dividend payments can provide a steady cash flow regardless of market conditions, offering a degree of insulation from short-term market volatility. Unlike relying solely on capital gains, dividends can help smooth out returns and reduce the impact of market downturns. This stability makes dividend-paying stocks especially appealing for risk-averse investors looking for reliable income.

b. Dividend Growth Potential: Many companies have a track record of consistently increasing their dividend payouts over time. By investing in such companies, investors can benefit from the potential for dividend growth, which can outpace inflation and enhance the purchasing power of their income stream. Dividend growth can contribute significantly to long-term wealth creation, making dividend-paying stocks an attractive proposition for investors with a focus on income growth.

2. Capital Appreciation

Contrary to a common misconception, dividend-paying stocks are not limited to income generation alone. They can also provide the potential for capital appreciation, thereby offering investors a dual benefit. Companies that pay dividends are often well-established, profitable, and possess strong fundamentals. By investing in these companies, investors have the potential to enjoy both regular dividend income and the possibility of long-term share price appreciation.

a. Dividend Reinvestment: Dividend payments can be reinvested to purchase additional shares of the company's stock and by reinvesting dividends, investors can take advantage of compounding returns, potentially leading to significant wealth accumulation over time. This reinvestment mechanism allows investors to harness the power of compounding and enhance the overall returns of their investment. As an example, assume a $100,000 investment with a 4% dividend. Assuming zero (0) dividend growth, after 20 years, the investor has received roughly 119% cumulative return just based on the dividend accumulation, a 5.95% average return, not counting any price appreciation. That return happened without relying on any increase in the asset price.

This information is hypothetical and is provided for informational purposes only. It is not intended to represent any specific return, yield, or investment, nor is it indicative of future results.

b. Total Return: When considering the total return of an investment, which includes both capital gains and dividends, dividend-paying stocks have historically demonstrated competitive performance. Studies have shown that dividend-paying stocks have outperformed non-dividend-paying stocks over the long term, providing investors with an opportunity to achieve superior risk-adjusted returns. How significant are dividends to the total return of equities over the long term? Very.

Per Morningstar research, here are some startling numbers:

In the decade of the 1940s, the S&P 500 had an average return of about 9% per year, of which 67% of that was from the dividend component. Only about 3% return was enjoyed based on just Price return.

- 1950s: dividends accounted for 29% of the total return of the market
- 1960s: 44% of the return
- 1970s: 73% of the return
- 1980s: 28% of the return
- 1990s: 16% of the return
- 2000s: 100% of the return, as the market had an overall price decrease
- 2010s: 17% of the return
- 1940-2019: Dividends accounted for 35% of overall market returns

If one ignores dividends, then one is eliminating a large portion of total market return.

3. Defensive Characteristics

Dividend-paying stocks often exhibit defensive characteristics that make them attractive during uncertain or challenging market conditions. These defensive qualities can offer a degree of stability and downside protection to investors' portfolios, reducing overall risk exposure.

a. Value Investing: Dividend-paying stocks are often favored by value investors due to their potential to provide a margin of safety. Companies that consistently pay dividends tend to be more mature, established, and less prone to severe price fluctuations compared to growth-oriented stocks. Such stability can provide investors with a sense of security and help mitigate the impact of market downturns.

b. Dividends as Signals: Dividend payments can serve as signals of a company's financial health and management's confidence in its future prospects. Companies that consistently pay or increase dividends demonstrate a level of financial strength and stability, suggesting that their earnings and cash flows are sustainable. These signals can provide investors with valuable information for making informed investment decisions and identifying companies with solid fundamentals.

c. Risk Mitigation: Dividend-paying stocks have historically shown lower volatility and downside risk compared to non-dividend-paying stocks. During market downturns, dividend payments can act as a type of buffer, providing a degree of downside protection and reducing the overall risk of the portfolio. By investing in dividend-paying stocks, investors can potentially reduce the impact of market fluctuations on their investment capital.

Conclusion

Investing in dividend-paying stocks offers investors a range of compelling benefits. The steady income stream provided by dividends can serve as a reliable source of cash flow, while the potential for dividend growth and capital appreciation offers the opportunity for long-term wealth accumulation. Additionally, dividend-paying stocks exhibit defensive characteristics that can help mitigate risk and provide stability during market downturns. By considering these factors and incorporating dividend-paying stocks into their investment strategy, investors can potentially enhance their portfolio's overall performance and achieve their financial goals.