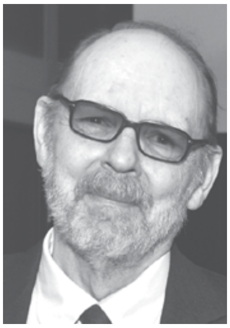

Constructing A Really Large-Cap Dividend Portfolio

David W. Stanley

One of our ShareClub members sent me an interesting article ("A Whole New Way To Beat The Market", Andrew Hallam, Canadian Business, June 11, 2012, pg. 57) about the current endeavours of Michael O'Higgins, inventor of the 'Beating The Dow' method that I transmogrified (i.e., plagiarized) into 'Beating The TSE'. Mr. O'Higgins' methodology has worked well; since 1973 the Dogs have had just five losing years, and averaged 14.8% annually over the past 39 years, compared to 9.7% for the S&P 5OO. In other words, Beating The Dow has outperformed the index by over 50% for 39 years while our Beating The TSX only beat the index by 28% for 25 years. In my defense I should say that the benchmark we use is the total return for a narrow blue-chip index while the Dogs uses a much broader share price index. In any case I think we can both hold our heads up and be pleased that we brought a tried and true process to individual investors that allows them to achieve significantly higher returns than the index with a minimum of effort and cost by using a passive investment strategy.

Mr. O'Higgins is now in the process of developing a new investment approach focused on providing decent returns and improved safety. That made me think that in these perilous times it might be worthwhile to re-examine 'Beating The TSX' to see if anything can be done to improve the procedure, especially with respect to safety. Over the years I have been given many suggestions for improving our method such as including a P/E screen, taking into account debt loads, and estimating company governance. To all of these I just smile and reply, "Sure, why not? You try it and tell me how it works". To date no one has taken me up on the offer.

Over the past few years various academic studies have demonstrated, at least to my satisfaction, that large-cap stocks out perform small-cap stocks, that dividend payers out perform non-dividend payers, and that low beta stocks outperform high beta stocks. Taking these results as my jumping-off point, it seemed to me that the place to find such companies in Canada was at the apex of the S&P/TSX 60 index. I have often wondered aloud if all the 60 companies in this index really qualify as true blue-chip stocks. Thus, I decided to concentrate on just those that would surely pass the test. I ranked the index by market-cap and selected the top 15 names (Table 1).

Table 1. Biggest Canadian Market-Cap Companies of the S&P/TSX 60 Index.[1]

Sym.	Company	Price	Market Cap (B$)	Yield (%)
RY**	Royal Bank	$49.90	72.1	4.53
TD**	TD Bank	$77.66	70.7	3.70
BNS*	Bank of Nova Scotia	$51.53	58.8	4.24
SU*	Suncor	$28.33	44.2	1.79
ABX	Barrick Gold	$39.60	39.6	2.05
CNR	Canadian National RR	$83.70	36.5	1.79
IMO*	Imperial Oil	$42.28	35.8	1.12
BMO*	Bank of Montreal	$53.88	34.7	5.18
POT	Potash	$38.87	33.4	1.46
G	Goldcorp	$39.95	32.4	1.38
BCE*	BCE Inc.	$41.79	32.3	5.18
ENB*	Enbridge	$39.38	30.9	2.90
CNQ	Canadian Natural Resources	$27.20	30.5	1.50
TRP*	TransCanada Corp	$42.25	29.8	4.16
CM*	CIBC Bank	$70.33	28.5	5.11
			AVG.	3.07

[1]Data as of June12, 2012, Sources: TSX, Globe and Mail
*DRIP & SPP plans
**DRIP plan only

I don't believe anyone would question the bona fides of these companies, always keeping in mind, of course, the likes of Nortel and RIM. We have fair diversification in these 15 companies; energy and materials-6 stocks, financials-5 stocks, utilities-2 stocks, telecom and transportation-1 stock each. I think that 15 is still too large a number so I pared our list down to an arbitrary eight, based mainly on dividend yield, but also with the proviso that there must be at least one company from each of the four S&P/TSX Composite Index sectors with the highest group dividend yields. Currently these are, in order, telecoms, utilities, real estate, and financials. Since there are no real estate companies in the top 15 I chose Canadian Real Estate Trust (REF.UN) for its market cap, longevity, and low payout ratio. The final results are shown in Table 2 ranked by yield.

Table 2.
A large-cap portfolio of Canadian high-yielding stocks.[1]

Sym.	Company	Price	Yield (%)	Beta
BCE*	BCE Inc.	$41.79	5.18	0.209
BMO*	Bank of Montreal	$53.88	5.18	0.905
CM*	CIBC Bank	$70.33	5.11	0.952
RY**	Royal Bank	$49.90	4.53	0.911
BNS*	Bank of Nova Scotia	$51.53	4.24	0.907
TRP*	TransCanada Corp	$42.25	4.16	0.249
REF.UN	Canadian Real Estate Trust	$39.61	3.76	0.251
TD**	TD Bank	$77.66	3.70	0.857
		AVG.	4.48	0.655

[1]Data as of June12, 2012, Sources: TSX, Globe and Mail
*DRIP & SPP plans
**DRIP plan only

There you have it — a portfolio of large-cap Canadian high-yielding stocks designed for safety and total returns. Safety comes from selecting large-cap stocks (too big to fail?), with high yields (signifying a lower price; all these stocks are off their 52-week highs), and low betas (the average beta of the group is only 2/3 of the volatility of the S&P/TSX Composite Index). Total returns come from high dividend yields (4.48% vs. 3.23 for the S&P/TSX 60 Index) and increasing share prices.

But, I can hear you now, "Five banks??? Yikes!!" If you look on page 15 of the July/August 2011 *MoneySaver* you will see my 10-year data for Canadian banks. An average total price increase of 222%; an average total dividend increase of 161%; and an average current payout ratio of 44.5%. Too much of a good thing? We will see. Here is a quote from 2012 OECD Economic Survey of Canada, "The (Canadian) economy withstood the global economic crisis thanks to a timely macroeconomic policy response and a solid banking sector." I'm OK with holding these bank stocks.

Does this mean there is a change of direction for our 'Beating The TSX'? Nope, just an exercise in portfolio construction that I will follow for a year to see how it performs. Readers, as I always say, should do their own due diligence. I think we all agree that stocks are not now, nor have they been for several years, trading on their fundamentals. A little extra safety built into a portfolio seems wise at this point considering the potential pitfalls that lie ahead. As always, I hope this column will generate discussion and I will attempt to answer your questions within the guidelines set by the *Canadian MoneySaver*.

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