Investing In Canadian Dividend Stocks
(Part 3)

By David Stanley

In the final article in this series we will finish our discussion of investing in Canadian dividend stocks by examining how individual investors can acquire shares in these companies. The previous article explained the workings of mutual funds and exchange-traded funds, but these vehicles allow only indirect ownership. If you wish to have control of your investments, then purchasing stocks is necessary. Before the advent of online discount brokerages stock procurement was often a complex and expensive undertaking. Now it has become comparatively simple to build a portfolio in registered and non-registered accounts without the need for a stockbroker.

In order to reap the benefits from a portfolio of Canadian dividend stocks three goals must be achieved. First, the proper stocks must be selected, second, they must be acquired at a reasonable price, and third they should be held for a lengthy period of time. The beginning investor should consider the following:

1. The Canadian stock market, as denoted by the S&P/TSX Total Return Index, has outperformed the U.S. and world benchmarks over the past 10 years when expressed in Canadian dollars.

2. Large cap, blue-chip stocks generally have higher returns than small companies and they are safer since the dividend yield acts as a cushion in falling markets.

3. Companies that pay dividends outperform those that don’t and, over the long haul, dividends represent a large fraction of an investor’s returns. This is shown in Figure 1.

Comparison of the S&P/TSX Composite Index by Price and Total Return

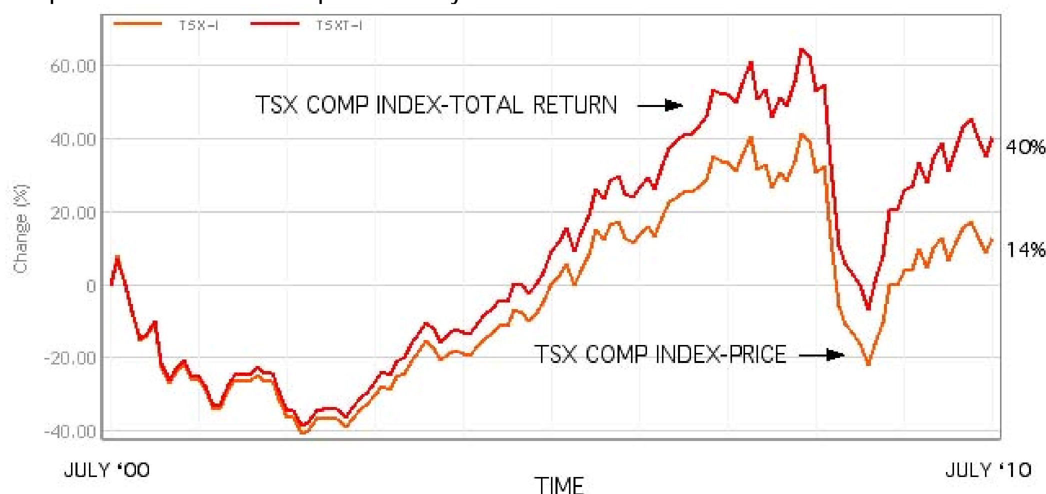

Figure 1. Influence of dividends on TSX returns over the past 10-year period. Data from *The Globe and Mail*.

An index that contains Canada's blue-chip dividend stocks is the S&P/TSX 60 Index, a list of the 60 largest companies on the Toronto Stock Exchange as measured by market capitalization. Not all these stocks, however, pay significant dividends. Rather than providing a list of all 60 of these companies, Table 1 gives the top ten-yielding stocks (excluding income trusts since most have been shut down by government mandate).

Table 1. Highest-yielding common stocks of the TSX 60 Index.[1]

Company	Symbol	Price ($)	Yield (%)	Sector
Manulife Financial*	MFC	13.00	4.01	Financials
TransAlta Corp.*	TA	21.91	5.35	Utilities
Husky Energy	HSE	25.12	4.78	Energy
Sun Life Financial Inc*	SLF	26.64	5.40	Financials
Power Corp of Canada	POW	26.99	4.29	Financials
BCE Inc.*	BCE	33.80	5.43	Telecommunication
TransCanada*	TRP	38.36	4.16	Energy
TELUS Corp.*	T	46.03	4.40	Telecommunication
Bank of Montreal*	BMO	59.76	4.67	Financials
CIBC*	CM	73.96	4.73	Financials
AVG.			4.72	

[1]As of September 29, 2010. Data from *The Globe and Mail*.

*These companies offer both DRIPs and SPPs.

The average yield for these 10 stocks is 4.72%, compared to 2.70 for the entire index. Currently, GIC rates range from only around 1-2% for a one-year duration to 3-3.5% for a five-year certificate, and dividends receive favourable tax consideration outside a registered account. I don't want to leave you with the impression that just because a company sports a high yield it is not automatically a good investment. Since yield is calculated by dividing the dividend by the stock price, it can occur that abnormally high yields will be a warning signal of waning prices. Thus, some historical perspective is needed. Also, you

can see from Table 1 that this list seems overweighted in financial stocks. This is often the case with any Canadian blue-chip index due to our preponderance of large-cap financial stocks. This isn't necessarily a problem, as seen in Figure 2.

Comparison of the S&P/TSX Composite and Financial Indexes

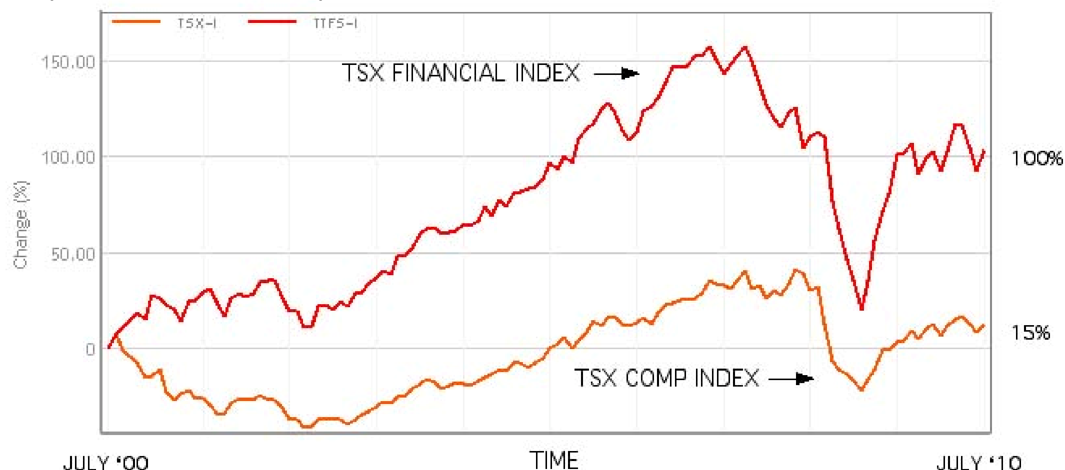

Figure 2. Comparison of the TSX Comp Index with the TSX Financial Index over the past 10-year period. Data from *The Globe and Mail*.

Common stocks such as those given in Table 1 are a starting point for constructing a diversified portfolio of high-yielding Canadian blue-chip companies. Another indicator of good quality dividend stocks is the frequency and amount by which they increase their dividends. Purchasing these stocks at a reasonable price is another important consideration. It is a truism that stocks of good companies rarely go on sale. They are widely held and very liquid, thus any mispricing is quickly seized upon by the market. On the other hand, most stocks go through an undulating cycle or range of value as they fall in and out of favour with investors. An easy way to take advantage of this is to buy them when their yields are at the high of the normal range, indicating that the prices are low. It follows that investors should be patient when acquiring stocks and wait for a good entry point. It pays off in the long run.

Finally, perhaps the most important benefit of owning high dividend stocks is the compounding effect, by which dividends are reinvested to generate their own added returns. To obtain the full value of compounding the initial investment needs to be held for a sufficient period of time (Figure 3).

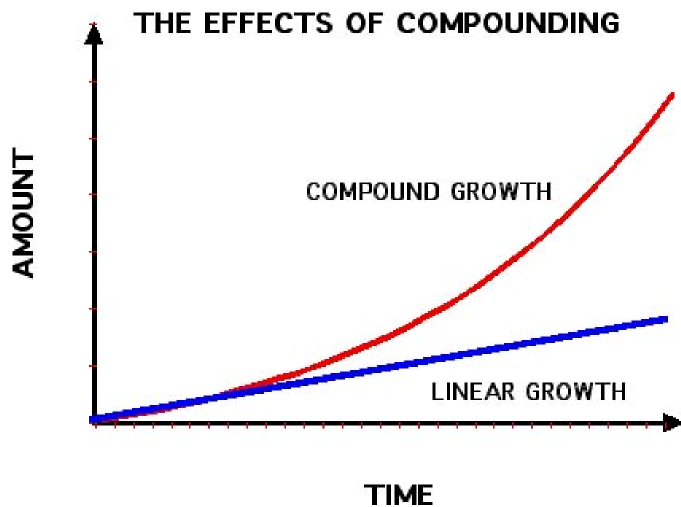

Figure 3. How compounding influences returns over time.

An excellent way for individual investors to achieve compounding is through DRIP investing. Of the 10 stocks in Table 1, the eight indicated by asterisks offer both DRIPs (Dividend Reinvestment Plans, allowing the reinvestment of dividends at no cost) and SPPs (Share Purchase Plans, allowing the purchase of new shares at no cost). These plans are bargains and should be employed by investors.

Individual investors require the personal attributes of courage and patience in order to succeed. For example, the recent (and perhaps ongoing) "Great Recession" has caused great upheaval in the investing community. So far, it seems that the best course would have been to have the courage to stick with your investing plan and the patience to wait out the downturn. While not everyone is constituently equipped for riding out huge swings in the market, those that can are often rewarded. For those of you for whom these brief articles have generated an interest, I would suggest reading my "Beating The TSX" columns in the *Canadian MoneySaver* magazine.

I hope you find this information useful and if you have questions please pass them along to Dale Ennis at the *Canadian MoneySaver* who will forward them to me.

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