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Sterling Investment Advisors Ltd.
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"Should I consider high-quality dividend stocks?"

By Timothy E. Flatley

With interest rates at or near historic lows, investors are more challenged than ever to find income-producing investments. Conventional sources of investment income are often failing to provide even modest returns. Money market funds' yields are imperceptible and those of certificates of deposit are negligibly better. High-quality bonds have traditionally generated higher yields with slightly greater risk, but they, too, are struggling to keep pace with inflation.

With this in mind, another option is to invest in sound companies that pay generous dividends. You could start by asking your advisor for a list of high-dividend-paying stocks or by doing research on a number of financial websites that produce these lists. Once you have compiled the list, you must carefully narrow it down to the companies to buy, to try to maintain lower portfolio volatility.

It is important that the company operates in an industry that is somewhat economically insensitive. These are companies with products that consumers purchase no matter what the state of the economy. A company such as Pepsi is a good example because a weak economy is not going to deter most people from spending a few dollars on their favorite soft drink.

You also want to make sure that the winds of change do not bring adverse conditions to the company in which you invest. For example, expiring patents and a shallow pipeline could foreshadow troubles for a seemingly strong drug company. Anticipating poor earnings can help you avoid a company that may struggle to meet its lofty dividend expectations.

A high-yielding stock is of little value if the company is not making enough money to pay its future dividends. This is measured by the payout ratio (dividend divided by earnings). We like to see a company that does not have to pay out more than 50 percent of its earnings to honor its dividend. We particularly like companies that grow their earnings on an annual basis and are able to increase their dividends every year as well.

Increasing yield in your portfolio is quite challenging in the present economic environment, with inflation negating the returns of traditional income sources. But finding some good dividend stocks can help. While volatility may increase, a significant dividend will lessen the effects of short-term price fluctuations and enhance the long-term growth potential.

HOW TO SELECT A GOOD DIVIDEND-PAYING STOCK

- Run financial filters on companies
- Consider the industry
- Verify a sustainable payout ratio
- Compare analysts' ratings from companies such as Standard & Poor's
- Focus on consistently strong earnings histories
- Look for companies that increase their dividends annually

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