Dividends can offer another option for investors seeking income

INVESTORS OFTEN USE THEIR PORTFOLIOS as sources of income, especially during retirement. With interest rates at historic lows, it can be difficult to meet income objectives solely through purchases of corporate or government bonds, or by investing in fixed-income mutual funds. Dividend-paying stocks, and the mutual funds that invest in them, may offer an additional source of income.

The dividend play

Corporate profitability overall is high and balance sheets are the strongest they have been in decades. In an uncertain market environment, many companies again are choosing to use their cash for dividend payments.

As of September 30, 2015, more than 80 percent of S&P 500 Index companies were dividend payers and 40 percent of those had a dividend yield — the payout as a percentage of the stock price — that was higher than the 10-year corporate bond yield.[1] More specifically, the 10-year Treasury bond yield at the end of September was 2.1 percent, the 10-year corporate bond yield was 3.4 percent and the S&P 500's average dividend yield was about 2.2 percent.[2]

In addition, dividends from strong companies not only can offer higher income than low-yielding bonds, they can do so at times without the extra risk and leverage of high-yield fixed-income securities, which were yielding about 5.7 percent at the end of September.[3]

Outside the U.S., companies with low or no debt and free cash flows also are paying dividends, and often at higher yield rates than U.S. companies. The differences in many cases reflect the changing economics around the globe, with growth in developing and emerging markets driving demand for the products and services of multinational firms.

Dividend Yields in Selected World Markets

(in percent; e = estimated)

Country	2013	2014	2015e
Australia	4.2	4.6	5.4
Chile	2.2	2.2	3.7
China	3.1	3.1	3.4
France	3.2	3.3	3.6
Germany	2.9	2.7	3.1
Japan	1.7	1.8	2.1
Singapore	3.2	3.4	4.3
Switzerland	2.8	2.8	3.1
Taiwan	2.8	2.9	4.2
U.K.	3.5	3.8	4.3
U.S.	1.9	2.0	2.1

Source: Credit Suisse, September 30, 2015

Dividends and mutual funds

Put simply, companies can share their profits with stockholders — including stock mutual funds — by making cash payments in the form of dividends. The stock mutual funds that receive these dividends then are required to pass them along to fund shareholders in regularly scheduled payments — typically quarterly, semiannually or annually. Shareholders also usually can choose to reinvest their dividends in the fund or take them as cash payments. Mutual funds specializing in dividend stocks reported inflows of $80.9 billion for the five years ending September 30, 2015.[3]

When researching dividend-paying companies, investment managers review factors including strong cash flow, less leverage on the balance sheet and solid opportunities for growth. Those features are among the indicators that demonstrate a company can support ongoing dividend payments. Remember, dividend-paying companies may choose not to pay a dividend or the dividends may be less than anticipated. But dividend issuers could fall in one of two categories:

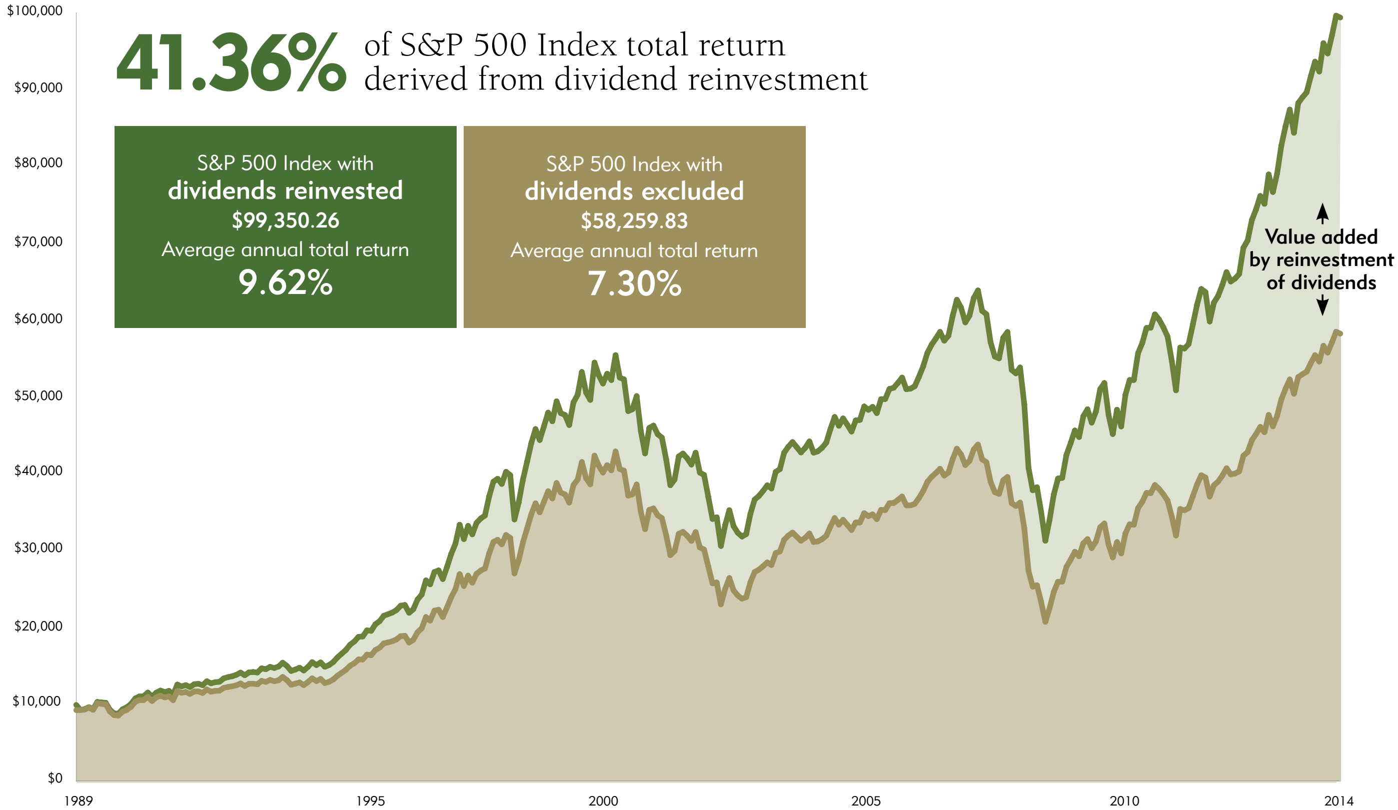
- Dividend payers — companies with a long history of growing dividends at rates significantly higher than inflation
- Dividend growers — companies whose long-term business prospects offer the potential to increase their dividend at rates higher than inflation or to begin paying a dividend in the near future

Potential inflation protection

Fixed-income investors who are concerned about inflation often invest in very short-term or inflation-indexed securities as a way to counter that risk. But those types of securities offer very low yields now. For example, a 1-year Treasury bill was yielding less than 0.4 percent in late September and a 1-year bank Certificate of Deposit was paying average interest of only 1.15 percent.[4]

Dividend-paying stocks have the potential to offer some alternative inflation protection. For example, as prices rise with inflation, corporate earnings often rise and allow dividend payments to increase. Interest payments on bonds, however, remain static unless they are inflation-indexed or carry a variable rate, which most do not.

In addition, if a company has pricing power for its products and can maintain or even grow profit margins during inflationary times, its share price may rise — but bond prices typically will fall. With inflation in the U.S. running at an annualized rate of 0.2 percent through September 2015[5], dividend yields higher around the globe provide a potential base for inflation protection in a portfolio.



Source: Morningstar

The graph illustrates the hypothetical growth of a $10,000 investment in the S&P 500 Index (including and excluding the dividend reinvestment) over a time period of 12/31/1989 through 12/31/2014.

Past performance is not a guarantee of future results.

The S&P 500 Index® is composed of 500 selected common stocks chosen for market size, liquidity, and industry grouping, among other factors. It is not possible to invest directly in an index.

The case for dividends now

The current slow pace of global economic growth, especially in the developed world, and forecasts for this pace to continue could mean slower corporate earnings growth in the years ahead. For example, earnings for S&P 500 companies in the third quarter of 2014 showed a 12 percent increase from the same period a year ago, while earnings for the second quarter of 2015 showed a 16 percent decrease.[2] The situation may add to the potential appeal of dividends for investors seeking income.

At Ivy Funds, we think companies with strong business models and brands, clear market opportunities, strong cash flows and the operational ability to fuel revenue growth will prosper. Dividends paid on the stocks of such companies can contribute to an investment income stream, add diversification to the stocks component of a portfolio and reduce volatility. Remember, diversification does not ensure a profit or protect against loss, although it can help reduce the overall risk and volatility of an investment portfolio.

[1] Source: FactSet
[2] Source: Bloomberg
[3] Source: Simfunds MF
[4] Sources: U.S. Department of the Treasury, www.bankrate.com
[5] U.S. Department of Labor

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