

InvestWrite Essay

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Question: Lets say you are going to give your parents an allowance by investing in stocks that pay dividends. Pick three stocks in different industries that pay dividends and tell us why you chose them. Did they pay a high dividend compared to other stocks? Have they paid dividends for a long time? Describe why dividends are important when evaluating a stock. Finally, would you tell your parents to reinvest their dividends, to buy more shares of stock, or take cash payment?

Dividends as an Allowance

Successful companies sometimes decide to distribute their income to shareholders. A dividend is a cash payment from a company's earnings. The dividend is most often measured in terms of the dollar amount each share receives, or it can be measured in terms of a percentage of the current stock price, referred to as dividend yield. When a company earns profits, management can do one of two things with the profits. It can choose to retain and reinvest them into the company with the hopes of creating more profits and thus further stock price appreciation. The other alternative is to distribute a portion of the profits to shareholders in the form of dividends.

If I were to give my parents an allowance, by investing in stable companies that pay dividends, I would choose the following stocks: Frontline Limited (FRO), Novastar Financial (NFI), and Southern Copper Corp. (PCU). All three of these companies could be part of a diversified portfolio, and all have a high dividend yield.

From the copper industry, I chose Southern Copper Corporation for its high dividend yield. Since there is a limited supply of materials on earth and the demand is increasing everyday, this can be a great investment for a long period of time. Southern Copper pays much higher dividend than its competitors and has been paying dividends consistently, since it started trading its stock in 1996. During the last 10 years its stock price has increased 7 times from \$7 to \$50 and it has paid dividends 42 times. It has a dividend of \$5.50 with a dividend yield of 10.10% based on \$54 stock price. Southern Copper's dividend yield for 2007 of 10.10% and 5 year yield of 4%, is higher than its competitor Phelps Dodge with yield for 2007 of 0.8% and 5 year yield of 1.4%.

Frontline is an oil tanker company that pays out a high dividend of approximately \$6.00. With an increasing demand for oil, more oil needs to be imported. I think that the demand for oil tankers will increase as oil needs to be moved from oil producing countries. Investors of this company should hold the stock for a long time because, in addition to the gradual stock price increase, the dividend payout will add greatly to the total profits. The dividend yield is about 15.70% with a \$38.00 stock price. In the last 5 years Frontline has paid dividend 24 times with an average of 17.50%, while the stock price increased from \$14 to \$38.

From the financial industry, I picked Novastar for its high dividend yield. It pays out \$5.60 in dividend, which is a yield of 18.50% with a \$30.50 stock price. It is a stable company providing mortgage loans, which right now, is a good industry to invest in. It

pays much higher dividend than its competitors as well as most other companies. It has paid dividends 26 times in the last 9 years since it started trading in 1997 and during this time its stock price has increased from \$8 to \$30. It has higher forward year, 5 year average yield, and higher stock price increases than its competitors like CharterMac and Hanover Capital Mortgage Holdings.

Dividends are the main way for investors to profit from a stock without eliminating ownership of the stock. Most secure and stable companies offer dividends to their stockholders. Their share prices might not move much, but the dividend attempts to make up for this. Dividends send a clear and powerful message about the company's future earnings and performance. A company's willingness and ability to pay steady dividends over time, and its power to increase them, provides good clues about its fundamentals.

Since 1927, dividends have contributed over 44% of the total return of the S&P 500, with stock price increases giving less than 33%. If those same dividends had been re-invested, it would have given over 66% of total return in the same period. Based on this historical evidence of higher returns, I would also recommend that my parents reinvest all the dividend earnings to buy more stocks of these companies.

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