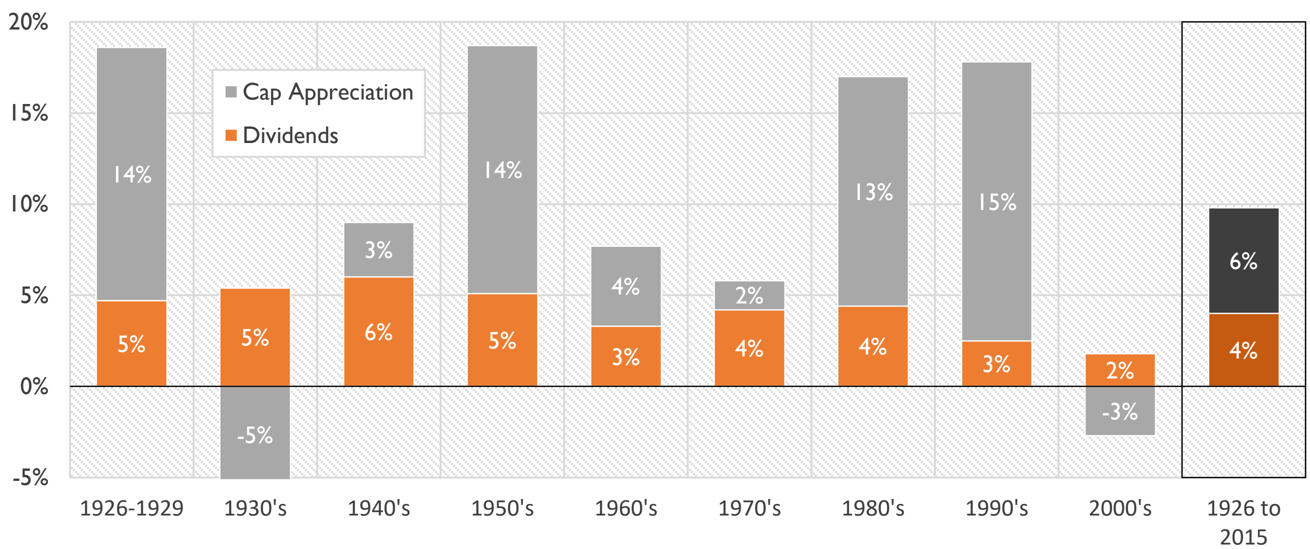
behavioral
ADVISOR

The Power of Dividend Stocks

Volume 5 | November 2016

In today's low-rate environment, dividend stocks represent an attractive alternative to bonds for generating both income and long-term growth. Separating the total return of the S&P 500 Index into the dividend and capital appreciation components shows the stability of dividend income going back to the 1920's with an average yield of 4.0%. Companies continued paying dividends even in the down markets of the 1930's and the 2000's. While more volatile, the capital appreciation component grew an average of 5.8% per year, easily outpacing the annualized 1.8% inflation rate over this time period.

S&P 500 TOTAL RETURN: DIVIDENDS & CAPITAL APPRECIATION (1926 – 2015)



Source: Ibbotson, Standard & Poors

The Financial Crisis of 2007-2009 caused many investors to fall behind on their retirement planning and the current low-rate environment makes it even more challenging for investors relying on investment income. Investors choosing bonds over dividend-paying stocks run the risk of having their savings eroded by inflation. The current 10-year US Treasury bond yields just above 2% which is barely ahead of today's annual inflation rate of 1.5%.

Having to rely on today's low rates for income is exacerbated by longer retirements. Based on research by Boston College, the number of years in retirement has risen from 13 in 1962 to 20 in 2013, and is expected to continue rising as people enjoy longer lifespans[1].

Dividend-paying equities represent an attractive source of investment income while also providing the opportunity for capital growth. This combination makes dividend stocks an important tool to help investors avoid exhausting their retirement savings.

From the Behavioral Viewpoint

What is going on?

1. Investors have an inherent bias against equities, considering them risky due to volatility while thinking of bonds as safe due to their stable principle (if held to maturity). We are more aware and sensitive to equity volatility and price fluctuation due to **availability bias**, the degree of emphasis based on how available is the information.
2. **Loss aversion**, the fear that a loss feels twice as bad as an equivalent gain, drives many investors to accept low rates of return with bonds in exchange for a stable principal.
3. The loss that investors either witnessed or experienced in the Financial Crisis of 2008-2009 is still a fresh memory for most. This **recency bias** can cause an overemphasis on short-term wealth preservation, particularly for investors nearing or in retirement.
4. We **underestimate** the corrosive power of low returns in combination with inflation on purchasing power.

What can we do?

1. Develop a structured plan to fit your specific situation and needs. We advocate a bucket approach to planning with sufficient assets allocated to key objectives: short-term liquidity, income, and long-term capital growth. These buckets can be managed to meet their respective goals while giving investors the confidence needed to avoid short-term emotional investment decisions.
2. Reframe how you look at your income portfolio recognizing both the income component and the potential for long-term price appreciation. Learn to focus on income generated and ignore short-term price movements on dividend-paying stocks, accepting that price variability is expected.
3. Ensure that a portfolio's dividend yield can support the desired withdrawal rate so that the capital appreciation component can have sufficient time to perform and outpace inflation.

Join Us

Financial professionals can gain access to this and other published behavioral investing resources by registering on our website:

www.athenainvest.com/register

IMPORTANT INFORMATION AND DISCLOSURES

1. Source: Boston College Magazine, Spring 2015