

## **More of a Good Thing Student Document**

Have you ever been surprised by your own success? You studied hard for a test, weren't confident in how well you did, but the results came in, and you got a perfect score! Don't be too shocked, because hard work and perseverance often produce successful results.

What would you do if you found yourself successful with money? You have a job, you're good at it, and you periodically get raises. After paying your expenses, you have money left over. Or, you start a small business mowing lawns in the neighborhood. You charge a good price, do an excellent job, and word spreads. The next thing you know, you are cutting more lawns than you had expected and earning more money.

If you are responsible enough to successfully create extra income, chances are you aren't about to waste it. You may treat yourself from time to time, rewarding yourself for the hard work. But what do you do with the extra money? Save for a car, upcoming college expenses?

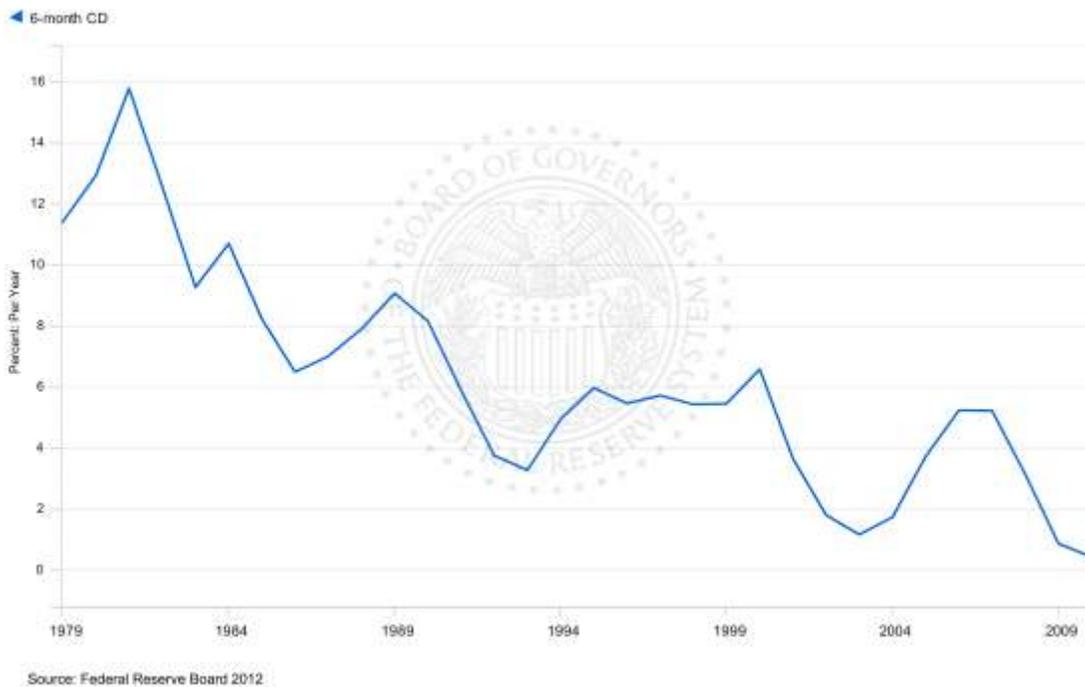
You've learned the power of compound interest and how saving money steadily and leaving it to grow will reward you with even more money. Saving extra money used to be clear: put money in the bank and let it earn interest. However, those days have been over for a while and might not get better anytime soon. Interest rates on savings accounts are as close to zero as you can get. Although interest rates paid on savings accounts vary by bank, generally the current rate on a savings account is .01% (that's one one-hundredth of a percent). If you deposit \$1,000 into a savings account paying .01% annually, you will receive:

$$\$1,000 \times .0001 = 10 \text{ cents}$$

Hardly worth parking your \$1,000 there, right? Of course, the FDIC (Federal Deposit Insurance Corporation) protects deposits in US commercial banks up to \$250,000. Money in a bank account is safe and a good way to protect it, but don't expect it to produce meaningful growth.

Currently, a bank's savings interest rates are low due to the economy sputtering for several years now. The Federal Reserve Bank (government agency responsible for watching over our economy) has been lowering interest rates steadily for years in response to sluggish economic numbers. The idea is to keep interest rates on borrowing low in order to encourage people and businesses to borrow money, and invigorate economic activity. Because banks have to loan money at low rates, they have to lower the rates they pay on deposits to fund those loans. So, as borrowing interest rates drop, so do savings interest rates. This is bad news for savers.

Here is a chart showing the average interest rate on a six-month certificate of deposit dating back more than 30 years. You'll notice that rates haven't been this bad for savers in all that time.



There are periods of decline and prolonged periods of rates ranging between 4% and 6%. You'll also notice rates declining beginning in the mid-2000's.

So, let's ask again:

- What do you do with extra money?
- Would you still put it in a bank savings account? Why or why not?
- Are there alternatives available that would bring you a 4% to 6% return?

### **Dividend-Paying Stocks**

You've heard of the stock market, but what are stocks? A share of stock in a corporation is a share of ownership. When you buy a share of stock, you are buying an ownership position in that company. If the company does well, the stock price rises, and you sell that share at a higher price, you make money. If the stock price falls and you sell it at a lower price than what you paid, you lose money.

Investing money in stock brings with it an element of risk. If the stock price falls you can lose money – that's a risk. Stock prices fluctuate every second, of every minute, of every day that the stock market is open. But, you don't need to concern yourself with these constant fluctuations. The current price of a stock doesn't affect your investment until you are ready to sell it. You purchased the stock at a certain price, and your investment is fixed at that price. If the stock has risen in price since you bought it, then selling it will bring you a profit. If you buy shares, hold onto them, and aren't selling the stock today, then the current price doesn't really matter. A good reason to purchase shares of stock and hold them for long periods of time is called dividends.

### **What Are Dividends?**

Some corporations pay dividends to their shareholders. A dividend is a sum of money paid regularly (typically quarterly) by a company to its shareholders out of its profits (or reserves).

Companies sometimes reward their shareholders by paying them a portion of their profits. If you purchase shares of a company that pays dividends and you hold on to those shares for a prolonged period of time, you will get paid. Typically every quarter, a company will pay  $\frac{1}{4}$  of its annual dividend amount. For example, if a company pays a \$2 annual dividend per share of stock, then you will receive 50 cents per share you own each quarter. Regardless of the daily stock price, you will continue to receive dividends each quarter, as long as you own the stock, and as long as the company continues to pay that dividend.

You can actually calculate what yield you will receive from holding the stock and accumulating the dividends, before you buy it.

Example: Metro Corporation is currently selling at \$25.00 per share and pays a \$1.60 per year dividend.

$\$1.60/\$25.00 = 0.064$  or 6.4%

That's right, a 6.4% yield on your \$25.00 investment!

### **Yield**

To calculate the yield you would receive from a dividend-paying stock, divide the annual dividend amount by the current stock price.

Yield = Dividend

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Current Stock Price

Calculate the current yield that would result by purchasing these shares of dividend-paying stock at these prices:

<b>Stock Price</b>	<b>Dividend</b>	<b>Yield</b>
\$20.00	80 cents	
\$40.00	\$1.20	
\$58.50	\$2.10	
\$82.00	\$1.55	

In recent years, dividend-paying stocks have become a popular investment for investors focused on income-producing investments. This is due to traditional fixed-income investments like bank accounts and certificates of deposit that are yielding next to nothing. Over time, stocks that pay a high dividend tend to outperform stocks that do not. From 1972 through September 2010, US-based dividend-paying stocks returned an average of 7.1% increase in price annually. Compared to the 1.5% average annual increase of non-dividend paying stocks, dividends are clearly an attractive choice.

Dividend-paying stocks have historically outperformed the overall stock market during periods when stock prices are weak. Companies that pay dividends are generally more conservative and have stronger cash flows, allowing them to pay their investors the dividends. Investors gravitate toward dividend-paying companies during times of trouble. By paying dividends to their shareholders, companies indicate the sense of strength in their business and their comfort in paying money to shareholders instead of saving it for tough times.

Investing in dividend-paying stocks offers two possible ways to earn money: price appreciation of the stock itself and the dividends received by holding the stock long-term.

Remember the \$1,000 we talked about putting in a bank savings account earning .01% and returning one dime? Let's compare:

(Costs associated with purchasing stock are called commissions, a fee paid to the broker for purchasing the stock for you. We will discuss that later, so for this example we will keep it simple.)

You invested \$1,000 in a dividend-paying stock that cost \$20 per share and paid 80 cents per year in a dividend. Exactly one year later you sold that same stock at \$23 per share.

- What would be your return on investment?
- How many shares of stock did you purchase?
- What was the dividend yield you expected at the time of purchase?
- How much money did you collect in dividends?
- When you sold, did you make a profit? If so, how much?
- What percent of your investment does that profit yield?
- How much money did you collect in excess of your initial \$1,000 investment?
- What is the total yield return on your one-year investment?

Typically, if you have an online brokerage account, you can buy or sell stocks for a flat fee called a commission. It's common for that fee to be \$10 per trade, buy or sell, regardless of the number of shares and the dollar amount of the transaction. Some companies will allow you to purchase shares through their websites commission-free; however, not all will allow you to sell shares.

Referring to the example, if your buy and sell transactions went through the online brokerage account, you would have paid \$10 to buy and another \$10 to sell the shares. Your total investment cost would have been \$1,020.

- What would this have done to your eventual yield?
- Would you still make the investment?

Before you run out and research companies with the highest yielding dividends, let's talk a bit more about risk.

In some cases, a high-yield dividend can be a warning sign. Not every company with a high dividend has strong fundamentals supporting that dividend, such as good earnings. It can be an attempt to lure investors into a stock of a company in trouble and one that cannot continue to pay that dividend in the future. Paying a high dividend can be an attempt to attract attention to a stock and raise its price, but it may have a depressed stock price for some fundamental reason.

Research will be important in determining if a company with a nice dividend yield is risky. Here are tips to keep in mind.

- Solid, mature, well-established companies raise dividends consistently.
  - Good companies that reward their shareholders have reputations to protect. Paying consistent dividends to its shareholders builds character and trust with investors, and that's a reputation most good companies would not break.
- Consistent dividends will compound over time.
  - If you reinvest the dividends earned from a company, you will consistently earn more dividends, which will purchase more shares.
- Strong companies that pay dividends tend to increase those dividends every year.
  - Some companies have been paying dividends and raising them every year for decades. This is a streak many would never want to break.

A dividend aristocrat is an S&P 500 company that has raised its dividend every year for the past 25 years. A dividend achiever has raised its dividend every year for the past 10 years.

If your dividends rise each year, so will your yield!

Example: If you were to buy a \$50 stock with a \$2.00 annual dividend, your yield is 4%. Now, if a couple years later, the dividend has risen to \$3.00 per year, your yield is now 6%! The stock price might have doubled to \$100 per share but you bought it at \$50 so your yield is 6%. Remember, your yield is fixed when you buy the stock unless the dividend itself changes.

### **Risk vs. Reward**

Earlier we discussed putting money in a bank savings account to protect it from loss up to \$250,000 from the FDIC. Saving your money in a savings account involves no risk but returns a low reward when interest rates are low. Finding good yield on your money can be achieved by investing in dividend-paying stocks. The reward can come from holding the stock long-term, collecting the dividends, and price appreciation of the stock.

However, there is risk involved in buying stocks, primarily from price depreciation (the stock price can go down). However, there may be a silver lining even if the stock's price drops.

If you purchase a share of stock at \$50 and it pays a \$2.00 dividend, your yield will be 4%. If the price of that stock depreciates to \$45 per share then you lost 10% of the value. But, you haven't actually lost anything unless you sell the stock at \$45.

What would the new yield be on this stock at \$45 per share?

$$\text{Yield} = \frac{\text{Dividend}}{\text{Price}} = \frac{2.00}{45.00} = 0.0444 = 4.44\%$$

That's right, the yield increased. Buying the stock at this price point is actually a better deal than it was at \$50.

If you purchased another share at \$45, what would your average yield be?

- The price you paid for both shares = \$50 + \$45 = \$95.
- The dividend you will receive from both shares is \$2.00 + \$2.00 = \$4.00.

$$\text{Yield} = \frac{\text{Dividend}}{\text{Price}} = \frac{4.00}{95.00} = 0.0421 = 4.21\%$$

What would be the average price you paid for your stocks?

$$\frac{\$50.00 + \$45.00}{2} = \frac{\$95.00}{2} = \$47.50$$

The average price paid for your stock decreased to \$47.50, but the average yield increased to 4.21%. Was that price drop a bad thing? Are you starting to see the beginnings of a stock purchasing strategy here?

### **Strategies for Success**

Let's not forget that you are already successful. You have extra money and wish to make it work for you. Purchasing a \$50 stock with a \$2 dividend for the long-term, not concerning yourself with daily price swings, will earn you a consistent 4% yield. This certainly beats the bank savings account alternative by a wide margin.

Should the stock price fall from your \$50 entry point, you could use that fall in price as an opportunity to improve upon your investment. Instead of investing all of your money at \$50, you could invest some of your money at that price, lock in the 4% return for the long-term, and wait. If the stock price falls below \$50, you would have money to re-enter the stock at the lower price, reducing your average price per share, and improving your average yield. Overall, you would make your investment even better.

If the stock price hovers around \$50 and you are comfortable doing so, you can then commit the money you held back to increase the number of shares you hold at \$50, and lock in the 4% return on all of your money. What if the stock price rises?

If your yield gets better when the stock price falls, then it should get worse if the stock price rises.

- What would the yield be on a stock at \$52 and a \$2.00 dividend?

$$\text{Yield} = \frac{\text{Dividend}}{\text{Price}} = \frac{2.00}{52.00} = 0.03846 = 3.85\%$$

Don't forget about stock price appreciation making you profit. When a stock price rises above your average purchase price, you have made money. You don't actually collect those profits unless you sell the stock.

Let's go back to the very beginning. You have money to invest and you are looking to make it grow. You decide you'd like to make a 10% return on the money. You found your \$50 per share dividend aristocrat or dividend achiever paying a \$2.00 per year dividend.

- How long do you need to hold the stock to achieve your desired 10% return by only collecting dividends?
  - By locking in a 4% annual return, you'll be receiving 1% per quarter in dividends. It will take 10 quarters, 30 months, or 2.5 years to complete a 10% return. This will achieve your goal by only using dividends and time.
- What would your return be if the stock price rose to \$55 per share, 30 days after you bought it?
  - A stock price rise to \$55 per share is a 10% increase. If you sold the stock at that price, you would achieve a 10% return target quickly by only using stock price appreciation.

Then there's the blended approach. You can achieve a 10% return quicker than 30 months if you are lucky enough to get some price appreciation along with dividends.

- If you held your stock for exactly one year, what would the stock price have to be on that day in order for you to sell the stock and achieve your 10% return?
  - Since you held the stock for one year, you have received 4% already by collecting the dividends. To achieve the desired 10% return, you'd need a 6% increase in the stock price.

$$1\% \text{ of } \$50.00 = \$0.50 \qquad 6\% \text{ of } \$50 = 6 \times \$0.50 = \$3.00 \qquad \$50 + \$3 = \$53.00$$

Using a blended approach, you collected 4% in dividends and another 6% in stock price appreciation, and achieved your desired 10% return in one year or four quarters.

Each of these three methods will work, and no method is better than the other. It all comes down to your patience and tolerance of risk.

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You can start by getting a current stock quote. This stock quote for IBM Corp was taken from Yahoo.com.

From the Yahoo.com home page, navigate to the left link bar (Yahoo Sites) and find the link “Finance.” Click it and find on the “Yahoo Finance Home Page” a textbox to type in a stock symbol next to a button that says “Get Quotes.”



There is plenty of current information about the stock you are researching. I've highlighted two important pieces of information.

- Point A - Shows the current annual dividend the stock is paying as well as the yield at this stock price.
- Point B - Shows the 52-week range of the stock's price. When determining if the current price of the stock is too high, too low, or in the middle, it can be useful to know its price range. IBM is trading at about \$187.00 per share, about 10 points above its low point for the year, and 24 points below its high point.

If investing in dividend-paying stocks seems like a reasonable alternative to a bank savings account, and you accept the risk involved with investing in stocks, then it is possible for you to achieve nice growth. Staying diligent and keeping an eye on your investments will help you enjoy long-term success.