Rising dividends point to opportunity

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What do IGM Financial Inc., Russel Metals Inc., Saputo Inc., Ritchie Bros. Auctioneers Inc. and Home Capital Group Inc. have in common?

All of these companies announced dividend increases during the first week of August. In the United States, Monsanto Co., Leggett & Platt Inc. and Dover Corp., among many others, also hiked their dividends.

This was the same week the U.S. government had its triple-A credit rating slashed, triggering a market bloodbath reminiscent of the 2008 financial crisis.

What are investors to make of these seemingly contradictory events? Two things: First, there are some serious problems in the global financial system that could put a dent in global growth and play havoc with stock prices. Second, the world is not coming to an end, a fact that was underlined by the market's powerful rebound yesterday.

As the recent spate of dividend hikes demonstrates, corporations are still making money and sharing the wealth with investors, a trend that will continue – albeit at a slower pace if fears of a double-dip recession come true. If you're a buy-and-hold dividend investor who can tolerate more market volatility, there's no reason to change your strategy now.

If you have a strong stomach, you may even want to turn the market's weakness to your advantage by picking up stocks that are suddenly a lot cheaper than they were just a week ago. After all, the only time stocks go on sale is when nobody wants them.

Let's balance the grim headlines with some less depressing data.

South of the border, S&P 500 companies posted an estimated 12-per-cent profit increase in the second quarter and are sitting on more than $1-trillion (U.S.) in cash. Excluding Bank of America – which posted a huge loss after a settlement with mortgage bond investors – second-quarter S&P 500 profits jumped about 18 per cent from a year earlier, and Thomson Reuters predicts double-digit growth will continue into 2012.

Given the strong profit outlook and record cash reserves, companies are in a good position to keep paying – and, in some cases, raising – dividends.

True, if the economy slows dramatically or sinks into recession, earnings estimates will come down and stocks that look cheap today based on forward multiples may not turn out to be such a bargain.

But if the idea of sinking new money into this volatile market terrifies you, there's no need to be a hero; you could simply choose to reinvest your dividends, which means you'll be picking up shares at lower prices should the market keep falling. Reinvesting dividends also allows you to take advantage of compounding, which is one of the key elements of a successful investing plan.

Just remember to stick to a mix of stocks and fixed-income that's appropriate for your age and risk tolerance. When markets are rising, as they did from March, 2009, through March, 2011, owning bonds and guaranteed investment certificates is as dull as watching Lawrence Welk reruns. But when stock markets tumble like they did recently, nobody can have enough of them.

As scary as Monday's stock market slide was, however, there are reasons to believe we are not heading into the abyss, à la 2008. Lowell Miller, president of Miller/Howard Investments of Woodstock, N.Y., and author of The Single Best Investment: Creating Wealth with Dividend Growth, points out that corporations are in much better shape than they were heading into the last financial crisis, even as governments are struggling under unsustainable levels of debt.

"Business seems to exist in a parallel universe, where debt is under control, revenues are not robust but are adequate, and earnings are flowing as any business owner would want them to," he said in a note to clients.

"If there is a recessionary flavour to things for a while, it will reflect simply a demand slowdown from cautionary sentiment, not the quavering fear that the last recession showed. Market conditions are ripe for a low very soon."

Given strong corporate balance sheets and investors' appetite for income, even if the economy slows markedly and companies start hoarding cash as they did in 2008, the result will likely be fewer dividend hikes rather than outright dividend cuts, he said.

Dividend stocks have several advantages, said Howard Silverblatt, senior index analyst with Standard & Poor's. Since 1926, dividends have accounted for about 42 per cent of investor returns, while being less volatile than the market.

"To some extent the dividend acts like an anchor, slowing the stock down," he said. "The beauty of dividends is that you get paid, whether or not the market is up."

In a market that can swing hundreds of points in a matter of minutes, knowing that a dividend cheque is in the mail is one of the few comforts an investor can have.