Dividend Stocks: Shelter From The Storm

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Dividend Stocks: Shelter From The Storm

By John Persinos (bio at end)
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Sixties rock legend Bob Dylan, the improbable but deserving winner of the Nobel Prize in Literature, sang about "Shelter from the Storm." During this tempestuous year, that is exactly what investor portfolios need.

Saber-rattling by North Korea, a brewing trade war, rising bond yields, stirring inflation, soaring federal deficits, bedlam in Washington — it is enough to make you afraid to follow the news. The correction that we witnessed earlier this year is far from over. Further stock market swoons probably lie ahead.

Now is a good time to put aside coverage of the market's daily gyrations and do a "deep dive" into a proven method for protecting your portfolio. I am talking about dividend stocks. Many investors underestimate their appeal.

Among the five biggest one-day declines in the history of the Dow Jones Industrial Average, three of them occurred in 2018:

Rank	Date	Close	Net change	% Change
1	2018-02-05	24,345.75	–1,175.21	–4.60
2	2018-02-08	23,860.46	–1,032.89	–4.15
3	2008-09-29	10,365.45	–777.68	–6.98
4	2008-10-15	8,577.91	–733.08	–7.87
5	2018-03-22	23,957.89	–724.42	-2.93

The market has since rebounded, which teaches us this timeless lesson: *Do not buy stocks that you would probably sell in a panic.*

You should methodically build a portfolio that you would want to hold in up or down markets. Accordingly, if you are an income investor frustrated with slowing dividend growth, keep your sense of perspective and follow my all-weather advice below.

Will 2008 Happen Again?

I don't think anything as devastating as the global financial crash of 2008 is in the cards right now, but you must contend with the prospect of additional market sell-offs.

Traditional income havens such as real estate investment trusts (REITs), master limited partnerships (MLPs), and utilities have struggled this year. Year-to-date, these sectors as a whole hover in negative territory, with MLPs significantly down despite rising energy prices.

The flagging performances of these three sectors have income investors scratching their heads. But in the words of billionaire super investor Warren Buffett: *"The rear-view mirror is always clearer than the windshield."* Don't dwell on where the market has been; focus on where it is going.

Bond yields are rising, which is detrimental to stocks. However, rather than obsess about Federal Reserve policy, focus instead on the underlying fundamentals of your investment choices.

To prepare for the market turbulence ahead, you should pare back your growth stock holdings and elevate cash levels. That said, quality dividend-paying stocks still have a lot to offer. Unlike bonds, stocks offer potential dividend growth and share-price appreciation. Moreover, rising interest rates will hurt bonds the worst, as more attractive fixed income opportunities emerge.

The key is to pick the right dividend stocks or funds. But it is a common mistake to solely focus on the obvious choices, such as REITs, MLPs, and utilities. Think outside the dividend box. One often overlooked income-generating sector is technology.

That's right, technology.

Tech stocks continue to enjoy upward momentum largely because of increased IT spending among corporate clients, confident consumers who are gobbling up the latest gadgets, and drastically lower taxes because of the tax overhaul bill signed in December.

Conservative income investors tend to shy away from the technology sector, because they perceive it as too risky and volatile. However, the quickening pace of innovation is driving earnings growth and cash flow in the tech sector, prompting many Silicon Valley giants to offer not only capital appreciation but healthy dividends as well.

If you want to retire comfortably, you need to build a multi-faceted portfolio that not only includes classic dividend payers (e.g. REITs, MLPs and utilities), but also stocks from other less obvious sectors that bestow dividend growth and the potential for capital appreciation. Contrary to popular misconception, the technology sector fits the bill on all counts.

Beware the Dividend Trap

When looking for dividend stocks, it is tempting to gravitate towards securities with the highest yields. This is not always the smartest strategy; there is more to a worthwhile dividend stock than just a high yield.

Also keep in mind that the highest-yielding stocks are generally expensive, because income investors used them as bond substitutes during the prolonged era of low rates.

Stocks that can generate steady and sustainable dividend growth, rather than the fattest yields, are better bets for dividend investors.

Sure, robust dividends are offered by well-known companies with solid balance sheets. But income investors often lose sight of the fact that high dividends also can be used by new or inherently weak companies as bait for investors.

A "dividend trap" is when investors hungry for yield are suckered into a high dividend yield, only to eventually discover that the underlying company is deeply troubled. That is when the dividend gets cut or eliminated and unsuspecting investors get hurt.

Always look for healthy payout ratios, plenty of cash on hand, and a history of earnings growth. These quality dividend payers demonstrate greater resilience during an environment of rising rates and market volatility.

The so-called "Dividend Aristocrats" always provide fertile ground for income investors. To earn the honorific Dividend Aristocrat, a company must typically have raised dividends for at least 25 years. More precisely, the company needs to have a managed dividend policy that increased its dividend every year for those 25 years.

These dividend powerhouses constitute the S&P 500 High Yield Dividend Aristocrat Index, an official index of the 50-plus highest dividend yielding stocks in the S&P Composite 1500. This Aristocrat Index is maintained by Standard & Poor's, which every December updates the list of companies that make the grade.

By its very nature, a Dividend Aristocrat tends to be a large and stable blue-chip company with a strong balance sheet. Many of these companies are familiar names that produce household brands. Because of their strong balance sheets and financial wherewithal, they tend to weather market ups and downs.

Case-in-point: During the financial crash of 2008, the Dividend Aristocrat Index fell 22%, whereas the S&P 500 fell 38%. That is just the sort of shelter you need as storm clouds gather again.

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John Persinos is managing editor of *Personal Finance* and *Radical Wealth Alliance*, as well as chief investment strategist of *Breakthrough Tech Profits*.

John has decades of experience in the technology and political realms. He's spent decades following emerging business and technology developments. From his time at *Inc.* and *Venture* magazines, to sharing breaking market news to millions of readers across Kiplinger's, Street Authority, Investing Answers, and TheStreet.com, if it's impacted investors in the past 30 years, John was there analyzing the news and interpreting the meaning for his readers. John also has experience with the inner-workings of Capitol Hill, serving as a press secretary to U.S. Rep. Byron Dorgan.

John holds undergraduate and graduate degrees from Boston University. He also completed the Davenport Fellowship in Business and Economics Reporting at the University of Missouri (Columbia).