Do Dividends Matter:  

Name: Greg Castell  
Advisors: Dr. Bob Dean & Dr. John Rapp

**Purpose:** To determine if a portfolio of stocks focused on dividends can create alpha (i.e. excess returns) in both declining and rising stock markets. At the margin, I have assumed critical factors in determining alpha are dividend yield, dividend growth rate, and dividend payout ratio. S&P 500 stocks were screened to compile a list of securities meeting the following criteria:

1. Price/Earnings < Market (S&P 500)  
2. 1 Yr. or 15 Yr. EPS Growth Rate > Market  
3. Return on Common Equity > Market  
4. Dividend Yield > 0%

**Portfolio Weighting Process**

\[ Yld_{it} = \frac{D_{it}}{P_{it}} \]

\[ Sum(Yld) = \sum_{i=1}^{n} Yld_i \]

\[ Yld_w = \frac{Yld_i}{Sum(Yld)} \]

\[ Yld_w \times 1,000,000 = DV_{it} \]

\[ Shares_{it} = \frac{DV_{it}}{P_{it}} \]

\[ PV_{t+1} = Shares_{it} \times P_{it+1} \]

**Conclusions**

- There is no single dividend weighting factor that consistently outperforms over all time periods of analysis.

- In the downswing period, dividend weighting appears important, as both Yield and 5-Year Dividend Growth Rate outperformed the equal-weighted benchmarks.

- In the upswing period, dividend weighting also appears important, since both 1/Yield and 5-Year Dividend Growth Rate weighting outperformed the equal-weighted benchmarks.

- Of all the dividend weighting factors, 1/Yield appears to have the strongest appeal since it strongly outperformed the benchmark portfolio long-term (2005 – 2011).

- All dividend factors outperformed the S&P 500 for all time periods.

**Table 6-A**  
Performance of GARP 1 vs. Dividend Portfolios  
(All Percentages = Dividend Portfolio Alpha - GARP Portfolio Alpha)

<table>
<thead>
<tr>
<th>Period</th>
<th>Yield</th>
<th>1/Yield</th>
<th>5 Yr. Growth Rate</th>
<th>Payout Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005-2011</td>
<td>-11.70%</td>
<td>17.76%</td>
<td>-18.84%</td>
<td>-24.16%</td>
</tr>
<tr>
<td>2006-2011</td>
<td>-9.47%</td>
<td>-0.76%</td>
<td>-3.81%</td>
<td>-9.70%</td>
</tr>
<tr>
<td>2007-2011</td>
<td>-9.28%</td>
<td>-7.17%</td>
<td>-6.80%</td>
<td>-10.47%</td>
</tr>
<tr>
<td>2008-2011</td>
<td>3.61%</td>
<td>-2.37%</td>
<td>5.00%</td>
<td>-7.60%</td>
</tr>
<tr>
<td>2009-2011</td>
<td>-18.29%</td>
<td>40.27%</td>
<td>-3.12%</td>
<td>-16.95%</td>
</tr>
</tbody>
</table>

**Table 6-B**  
Performance of GARP 2 vs. Dividend Portfolios  
(All Percentages = Dividend Portfolio Alpha - GARP Portfolio Alpha)

<table>
<thead>
<tr>
<th>Period</th>
<th>Yield</th>
<th>1/Yield</th>
<th>5 Yr. Growth Rate</th>
<th>Payout Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005-2011</td>
<td>0.96%</td>
<td>15.54%</td>
<td>-6.43%</td>
<td>-17.45%</td>
</tr>
<tr>
<td>2006-2011</td>
<td>-6.65%</td>
<td>-5.14%</td>
<td>-0.03%</td>
<td>-6.69%</td>
</tr>
<tr>
<td>2007-2011</td>
<td>-7.00%</td>
<td>-6.13%</td>
<td>3.53%</td>
<td>-9.66%</td>
</tr>
<tr>
<td>2008-2011</td>
<td>5.04%</td>
<td>-3.72%</td>
<td>6.02%</td>
<td>-10.01%</td>
</tr>
<tr>
<td>2009-2011</td>
<td>-16.72%</td>
<td>25.03%</td>
<td>3.76%</td>
<td>-24.38%</td>
</tr>
</tbody>
</table>

**Performance vs. Equal-Weighted Benchmarks**

- The original stock filter criteria set a very high standard.
- When dividend-weighting outperformed is critical.
- 1/Yield appears to have the strongest overall appeal, implying the presence of a hidden growth rate in low-yielding stocks.
- Dividend Growth Rate appears critical in market downturns.