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Do Dividends Matter: An empirical analysis of the impact of dividends on portfolio stock selection, portfolio weights, and portfolio returns for S&P 500 stocks over the period 2005-2010

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Do Dividends Matter:

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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

<table>
<thead>
<tr>
<th>Performance of GARP 1 vs. Dividend Portfolios (All Percentages = Dividend Portfolio Alpha - GARP Portfolio Alpha)</th>
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Table 6-B

<table>
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<th>Performance of GARP 2 vs. Dividend Portfolios (All Percentages = Dividend Portfolio Alpha - GARP Portfolio Alpha)</th>
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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