Can One Simple Strategy Outperform the TSX?

Description

Over the years, one strategy for American investors has seen its popularity ebb and flow, increasing at times but seemingly fading to obscurity at other times. This strategy is so simple in design that any investor can pull it off with just a small bit of research and a few minutes to execute the trades. And, since 2000, this strategy has pretty consistently outperformed the underlying index, increasing 128% compared to 111%.

This strategy is commonly referred to as the “Dogs of the Dow.”

All an investor needs to do is pick the 10 stocks of the **Dow Jones Industrials** (Index: DJI) with the highest dividend yields, take equal positions in each, and then reevaluate the positions after a year is up, switching out any company that is no longer in the top 10 or has cut the dividend. It’s a pretty easy strategy for something that outperforms on average every year.

One problem with the strategy is the Dow Jones Industrials only has 30 stocks, meaning choices are somewhat limited. Luckily for Canadian investors, they can easily replicate the strategy with the **S&P/TSX 60**, which should broaden the universe of potential stocks, although it is heavily weighted in financials and energy.

According to research done by Global Securities Corporation, the Dogs of the TSX beat the index handily in 2013, returning 19.87%, compared to 13.26% for the TSX 60 and 12.98% for the TSX Composite. The top performers were **Sun Life Financial** (TSX:SLF) and **Enerplus** (TSX:ERF), which were both up more than 50% in 2013. The Dogs were weighed down by **Transalta** (TSX:TA) and **Penn West Petroleum** (TSX:PWT).

Here is a list of the 2014 Dogs of The TSX. All information is as of January 1st.

Company	Ticker Symbol	Dividend Yield
Penn West	TSX:PWT	10%
Transalta	TSX:TA	8.6%
Canadian Oil Sands	TSX:COS	7%

Crescent Point	TSX:CPG	6.7%
Enerplus	TSX:ERF	6.1%
BCE	TSX:BCE	5%
Encana	TSX:ECA	4.4%
CIBC	TSX:CM	4.2%
Fortis	TSX:FTS	4.1%
Bank of Montreal	TSX:BMO	4.1%

The average dividend yield for the Dogs is more than 6%, giving this portfolio some impressive dividend power. As many investors know though, high dividends often come with high risk. Transalta has already cut its dividend in 2014, from 29 cents to 18 cents, quarterly. While this doesn't have a huge effect on the underlying portfolio, it still negatively affects returns, especially after the cut sent shares 20% lower in a matter of days.

These types of events are somewhat common with the Dogs of the TSX, and it still hasn't stopped them from outperforming. From 1987 through 2011, the Dogs of the TSX have returned 11.97%, compared to 9.34% for the TSX. It started off investing in the top 10 yielding stocks in the TSE 35, morphing the strategy once the TSE 35 was replaced with the TSX 60 in 1998.

One negative of the Dogs portfolio is the concentration in financials and energy, sectors which could very easily be affected by sector-wide factors. If the price of oil suffers in 2014 or if the Canadian housing market starts to roll over, this strategy could easily underperform.

Still, the strategy has outperformed over time, and that's partially due to the simplicity of the Dogs. While dividend yield isn't a perfect metric to measure underlying value, generally a company with a higher dividend yield is having some short-term problems. The yield is a representation of the overall value, and makes it pretty easy for investors to pick value stocks just using yield alone.

Foolish bottom line

The Dogs of the TSX is a simple strategy that makes it pretty easy for casual investors to identify value stocks. While I wouldn't go out and blindly buy all 10 of the stocks on the list, I think the 10 highest yielding companies on the TSX 60 would be a good place for an investor to begin their research.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:ERF (Enerplus)
2. TSX:SLF (Sun Life Financial Inc.)
3. TSX:TA (TransAlta Corporation)

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