Why Dividends Matter

Description

Some people ask, what's the big deal about dividends? They usually only make up about 3% of total returns. If we think about it, though, the average market returns quoted in the textbooks are 7-10%. So, a 3% yield makes up 30-43% of market returns. I say that's a big portion of the returns.

Using **Canadian Western Bank** (TSX:CWB) as an example, I'll show how dividends matter.

You could have bought Canadian Western Bank at $24 in 2010. More than five years later, you can still buy it just under $24. You may be thinking, "Hey, I didn't make any money at all!" But you forgot to factor in its dividend.

In 2010, Canadian Western Bank had an annual payout of 46 cents per share. So, if you had bought 100 shares of the stock at $24 at the start of 2010, you would have gotten $46 for your $2,400 investment. That would have equated to a yield of 1.9%.

In fact, from 2010 to the present, you would have collected in total $383 from dividends. This is 16% of your initial investment. The table below shows how much in dividends one would get for buying 100 shares at the start of 2010.

	2010	2011	2012	2013	2014	*2015
Annual Payout	$46	$56	$64	$72	$80	$87
Dividend-Growth Rate		21.7%	14.3%	12.5%	11%	8.8%

* Partial year: only three dividends paid out so far. Here, I assume the last dividend is the same as the third. If it follows the pattern of recent years, the annual payout would be projected to be $88, which would imply a 10% dividend-growth rate.

Instead of not making any money at all, you would have gotten 16% of your investment back. At the same time, your income from the investment increased 89% over five years, assuming the anticipated annual payout of $87 for 2015 materializes. Or the quarterly dividend could increase by one penny following the pattern of recent years.

The bank has a culture of increasing dividends, and it takes third place for having the longest streak of growing dividends in Canada. Actually, its dividend has grown for 23 consecutive years. Its payout ratio of about 30% also indicates the dividend is sustainable.

In conclusion

Of course, for every argument, there's a counter argument. For example, since the start of 2010 **Google Inc.** (NASDAQ:GOOGL)(NASDAQ:GOOG) has gone up 119%, and it has never paid a regular dividend.

To be honest, Canadian Western Bank and Google are very different businesses. One is a regional bank and the other is an innovative technology company. So, the main point of the article is that dividends matter to a portfolio, but it doesn't mean companies that don't pay dividends should be avoided.

Additionally, valuation also matters. Canadian Western Bank is cheaply valued with a multiple of nine, while it has traded above a multiple of 15 before. Because we cannot control which way the price goes, dividends can really matter.

CATEGORY

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Date
2025/08/24
Date Created
2015/09/23
Author
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