Huge Benefits Come With Value-Dividend Investing

Description

In the book *Brandes on Value: The Independent Investor*, it discusses the findings of a study on value investing. From 1968 to 1994, professors Josef Lakonishok, Andrei Shleifer, and Robert W.Vishny tracked U.S. stocks and grouped them based on fundamental metrics such as price-to-book and price-to-earnings ratios.

The study found that the stocks that were most undervalued delivered average annual five-year returns of 19.8% compared to the 9.3% return delivered by the group that was the most overvalued.

This shows how important it is to not overpay for stocks. However, if you have overpaid, it's not the end of the world; you'll just get lower returns.

Value investing also comes with other benefits.

Margin of safety

By definition, true value investing requires that a security be priced at a big enough margin of safety before warranting a buy. So, 15% might not be a big enough margin of safety; 50% is more like it. However, those are rare opportunities that occur once in a blue moon.

For example, in 2009 during the financial crisis, **Royal Bank of Canada** (TSX:RY)(NYSE:RY) hit a low of $25 when its fair value was $50. The other Canadian banks were in a similar situation.

The recession only managed to bring **Fortis Inc.** (TSX:FTS) down to about 14 times its earnings, while it typically commands a normal premium multiple of about 19, so at best Fortis was only discounted by 18%.

In the end, given that you choose quality businesses, the greater the margin of safety, the higher security you have in your invested capital.

Higher yield

If you apply value investing with dividend investing, you add another layer of safety. With each dividend you receive, you can view it as taking some of your investment capital back. As you look for a big margin of safety before buying shares in a quality dividend company, you also end up with a higher yield to start.

If you had bought Royal Bank in 2008 at $50 thinking it was a quality business that was fairly valued, you would have started with a 4% yield. If you'd held on to the 50% margin of safety principle before buying and bought it at $25 instead, you would have started with a whopping yield of 8%.

In the first situation, you would still end up with yield on cost of 6.5% today after the multi-year dividend hikes. In the second situation, you would end up with a yield on cost of 13%! Of course, I'm looking at the situation in hindsight, and you've got to wonder how many people bought Royal Bank at $25 and are still holding it.

Nonetheless, the lower the price you pay, the higher the yield you get, the more income you get from your dividend paycheques, and the faster you get your initial investment capital back.

Conclusion

In value-dividend investing, look for quality dividend-paying companies that have a big margin of safety from their intrinsic values. You have a higher chance of preserving your initial invested capital as well as boosting your initial income and long-term returns.

CATEGORY

1. Bank Stocks
2. Dividend Stocks
3. Investing

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1. Editor's Choice

TICKERS GLOBAL

1. NYSE:RY (Royal Bank of Canada)
2. TSX:FTS (Fortis Inc.)
3. TSX:RY (Royal Bank of Canada)

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