What General Electric Company's Dividend Cut Means for Canadian Investors

Description

U.S. giant **General Electric Company** (NYSE:GE) recently announced a dividend cut, halving the amount paid to investors, as the conglomerate continues to have a difficult time. Although company management made it clear that the decision to make this cut was in the best interests of total shareholders' returns, the market did not react well to this announcement. Shares of the company, which have traded at a 52-week high of US$32.38, declined from more than US$21.50 to less than $18 per shares in the days that followed the news.

While many retail investors bought into this behemoth due to the high dividend, the fact that has been missed by many is the new yield for shareholders purchasing shares today is almost 2.75% given this significant decline. At the previous 52-week high, the dividend was no more than 2.5%!

Although many investors are currently overreacting and selling out of their shares, it it important to realize that the metric known as yield on cash (YOC), which is the yield on a person's original investment, is not what is most important. Instead, income investors need to compare what they are currently being offered at with what else is available on the market.

Given the market's negative reaction to this dividend cut, many companies may now be loathe to cut their dividends until there are no other choice. For investors in Montreal-based **National Bank of Canada** (TSX:NA), this should be of particular concern. The company, which was one of the only major Canadian banks to ever cut its dividend (now a generation ago) in the 1980s and then again in the 1990s, investors may need to be very concerned once again.

The company has been the worst performing of all the big banks. It has seen earnings per share move sideways over the past four years, while the dividend-payout ratio (as a function of net profit) has increased from 38.5% in 2013 to 52% in fiscal 2016. Throughout the first three quarters of 2017, the bank has gotten things back on track, paying out only 42% of earnings as the economy in Quebec has been performing extremely well over the past year. Should the provincial economy turn once again, the bank, which has a very concentrated footprint, may face substantial risk. As a reminder, earnings in the banking sector have increased across the board for the period between 2013 and 2016.

Investors need not run from every name with an increasing dividend-payout ratio, but they do need to ask themselves why they are investing. As General Electric Company has clearly shown the market, it is very possible to cut the dividend in a preventative manner before being backed into a corner. Only time will tell what Canadian companies will do once the economy slows down.

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Author
ryangoldsman