



## WHERE DID ALL THE DIVIDENDS GO? AND WHAT DO YOU DO ABOUT IT?

It used to be that anyone wanting regular retirement income owned at least some dividend-paying stock. High dividend payers were utility companies, banks and stalwarts like IBM. But dividend-

paying stock—particularly those paying high dividend yields—is getting difficult to find. What do you do if you need the income?

Several factors have caused the decline in dividends. As stock market prices boomed, dividend yields shriveled because many companies didn't boost dividend payouts. The dividend yield of the S&P 500 today has shrunk to a tiny 1.7 percent (at one point earlier in 1998, it was 1.4 percent). That compares with an average dividend yield of 3.9 percent during the 1980s. Low inflation and interest rates keep dividend yields down, too.

The biggest factor is the growing disparity between regular income taxes and capital gains taxes. With ordinary income tax rates twice as high as capital gain rates for top-bracket taxpayers, stockholders want growth, not dividends. You also don't pay taxes on your gains until they're realized, unlike dividends. Corporations have responded by boosting share prices through repurchase or reinvestment instead of paying profits out as dividends. Growth is so much in demand, even some high-yielding utility stocks have cut or eliminated dividends. The average payout ratio—that portion of earnings paid out as dividends—has dropped to a near record low of 35 percent, versus an average payout since 1945 of 52 percent.

All this can be discouraging for retired investors looking for steady dividends to help pay for retirement. What can you do to replace this shrinking source of income? Your choices will depend on your needs, your overall investment plan, your risk tolerance, and so on, but consider some of the following options.

**Don't give up.** Solid companies still pay decent dividends, you just have to hunt a little harder for them. Even if yields aren't as high as they might have been in the past, higher-dividend paying stocks tend to weather market declines better because the dividends become more desirable. Some mutual funds kick off decent yields by specializing in investing in dividend-paying stocks or stocks with rising dividends.

**Go with the flow.** You may simply have to get used to the idea that a greater portion of total return from stocks, even traditional dividend payers, will come from price appreciation. To substitute for dividends, you periodically sell shares of appreciating stock for income. As mentioned earlier, the lower capital gains rate makes this strategy more attractive than ever before. If the idea of selling some of your principal is bothersome, consider leaving untouched the original investment, plus an inflation adjustment, and sell off the gains that exceed that amount. This strategy is problematic, of course, during market declines.

**Use low-risk buffers.** To protect against the risk of market decline, especially a simultaneous decline in stocks and bonds, or a decline in the value of a particular stock, you may want to periodically siphon off gains and reinvest them in low-risk vehicles such as money market mutual funds, certificates of deposit or fixed-income annuities. That way, you've protected the gains against any future market downturn. Keeping enough of your portfolio in low-risk liquid accounts such as money markets or CDs to cover living expenses for a year or two also reduces the need for dividend income just in case the market turns down.

**Consider fixed-income alternatives.** Most retirees have a portion of their portfolio invested in bonds or similar fixed-income investments. How much depends a lot on their risk tolerance and nonportfolio sources of income such as Social Security and pensions. If steady portfolio income is critical, you can beef up such options as municipal bonds, Treasury securities, corporate bonds and bond mutual funds, which typically yield more than stocks. The biggest problem is that if you load up too heavily on them, your overall portfolio may not keep up as well with inflation. Stock dividends historically have outpaced inflation. One also can look at high-yield bonds and real estate investment trusts, or mutual funds that focus on these assets, though volatility is higher with these choices.

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