The Role of Dividend-Paying Stocks

No matter your age or your approach to investing, there is one kind of investment that may be considered for your portfolio: dividend-paying stocks. That's the opinion of Scott Wren, Managing Director and Senior Global Equity Strategist for Wells Fargo Investment Institute.

While hardly the sexiest of investment choices, Wren says dividend-paying stocks may offer a difficult-to-beat combination — good quality and a history of typically lower volatility than the overall market. He likens this kind of investment to the slower competitor in the classic fable of the tortoise and the hare. The tortoise is not flashy or speedy, but over the long haul, he runs a steady and rewarding race. Wren cites an impressive number in this regard. "During the past 80 years, about half of the market's growth, as measured by the S&P 500®, has come from dividend-paying stocks."

The essentials

Some investors equate dividend-paying stocks with "blue-chip" stocks, but Wren is quick to point out that these terms are not interchangeable. While there are some longstanding, bellwether firms that pay dividends, such as AT&T and Johnson & Johnson, any number of large, high-profile social media and tech companies pay no dividends. They might be regarded as blue chip based on performance and growth potential, but they are not dividend-paying stocks.

Wren likens the presence of these stocks in your portfolio to breakfast items in your pantry. In the morning, you see staples such as name-brand coffee, cereals, and other breakfast foods, and you know the essentials are there. The quality is what you depend on, and you never have to think twice before starting your day right.

Not long ago, however, these stocks drew little interest and almost no enthusiasm. "From 1995 to the early 2000s, they fell out of favor while the focus was on the tech boom," says Wren. After that boom went bust, many investors were risk-averse. But with traditional conservative investment vehicles such as CDs (Time Accounts) yielding miniscule returns, investors started looking again at dividend-paying stocks. Wren notes that 5% CD yields are not likely coming back any time soon, so the trend is likely to continue. It's important to note that CDs may offer guarantees and insurance not available in stock investing. Investing in dividend-paying stocks involves the possible risk of principal.

The benefits

While younger investors typically may be better served by looking for greater growth at higher risk, Wren says, they also should consider having some dividend-paying stocks in their portfolio. The steady growth may have a payoff over time, especially if dividends are immediately reinvested in additional shares. For those approaching or in retirement, the scenario is a little different, and the importance of having this type of asset in your portfolio may be greater.

There's another quality, sometimes overlooked, of many dividend-paying stocks. A large number of corporations that pay dividends have significant interest and investment in emerging and global markets, which gives you additional exposure to that potential growth as well as the risk of these economies. Wren says that the populace's aspirations to reach the middle class in many countries translates to the production of commodities such as better hygiene products, higher-quality food, more modern appliances, and other goods that enable a healthier and more productive lifestyle.

"Many of the name-brand, dividend-paying corporations consistently produce these kinds of goods," notes Wren.

The drawback

He cautions, however, that any investor needs to understand that when interest rates rise, the returns of dividend-paying stocks could take a hit. And when the market experiences a big boom, these types of stocks do not always match the growth rate of other stock types. These are all reasons why it's important to maintain balance in your portfolio.

Even if you're aggressively seeking growth, it's important to hold some assets that may provide the potential for consistency.

This article was written by/for Wells Fargo Advisors and provided courtesy of David M. Gustin, AAMS®, Vice President-Investments in Melville, N.Y. at 631-753-4533