Sure Dividend

HIGH QUALITY DIVIDEND STOCKS, LONG-TERM PLAN

High Quality Dividend Investing Guide

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High Quality Dividend Investing Guide

This guide will show you exactly how to select high quality dividend stocks. More importantly, you will know the logic behind high quality dividend investing. You will have a simple investing system to easily implement high quality stocks into your portfolio in as little as 5 minutes a month. Finally, it is my hope you will find peace-of-mind in your investments knowing you are investing in fantastic businesses with a long history of profitability.

Why Dividend Stocks?

Common wall-street logic holds that dividend stocks are "safe", but don't offer high returns. This is only half-true. Dividend stocks are less volatile than non-dividend paying stocks. What is not true is that dividend stocks offer lower returns.

Dividend paying stocks outperformed non dividend paying stocks by 7.13 percentage points per year from 1/31/1972 through 2012[i]

Dividend stocks have historically *substantially* outperformed non-dividend paying stocks. The large majority of stock market gains over the last 40 years come from dividend paying stocks. Dividend paying businesses outperform because they:

1. Reward shareholders (by paying dividends)
2. Are generally profitable (because they can pay a dividend)
3. Are usually proven businesses (again, because they can pay a dividend)

Dividend stocks make excellent investments. This is not the entire story, however. Some dividend stocks perform much better than others do. When you focus on *high quality* dividend stocks trading at *fair or better* prices, you can systematically build a portfolio of the best-of-the-best businesses when they are ripe for investing.

How to Select High Quality Dividend Stocks

The process of selecting and investing in high quality dividend stocks is time consuming. Worse yet, every one of us (me included, of course) is overflowing with cognitive biases that prevent us from making the most logical decisions we can with the information available.

Cognitive biases occur not just in individual investors, but also with financial advisors, investment advisors, hedge fund owners, mutual fund managers, newsletter writers (uh-oh!), and all other investment professionals. Cognitive biases (and high fees) are why passive investment strategies (indexing) have outperformed active (stock selection) strategies[ii].

Percentage of actively managed equity funds underperforming benchmark for five years ended . . .

Category	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Large blend	94%	89%	75%	64%	56%	50%	44%	58%	65%	74%	66%	63%	67%	71%	75%	76%
Large growth	99	90	62	67	56	33	45	66	57	37	56	63	74	79	88	76
Large value	86	93	83	54	39	41	31	34	74	82	71	50	50	45	51	57
Mid-cap blend	88	70	76	81	71	60	65	60	80	81	78	73	70	75	68	78
Mid-cap growth	87	70	89	94	88	77	77	81	83	76	44	52	47	50	53	73
Mid-cap value	76	61	84	85	86	70	83	90	95	81	76	64	52	57	74	78
Small blend	44	67	23	21	20	18	21	38	51	83	62	67	70	69	79	80
Small growth	29	22	28	34	61	59	78	83	87	73	74	80	81	82	85	77
Small value	82	78	87	81	48	25	28	23	31	36	55	46	44	41	56	58

The takeaway from this chart is not that index investing is amazing, but that selecting stocks based actively, without a predefined plan, is hazardous to your wealth.

How to Use Systems to Beat Behavioral Flaws

The way to overcome cognitive biases is through systematic investing. Systematic investing focuses on building a *logical system* to identify attractive investments rather than relying on "gut feel" and hoping for the best. Systematic investing has historically done very well because it avoids cognitive biases (see Quantitative Value by Gray & Carlisle for more).

Using systems that define when and what to buy and sell eliminates emotion from investing. Without emotional investing, we are free to make the most logical investing decisions. Sure Dividend's 8 Rules of Dividend Investing are quantifiable and based on research. Each rule is influenced by many of the greatest investors of all time. Rules 1 to 5 show what high quality dividend stocks to buy. Rules 6 and 7 determine when to sell. Finally, Rule 8 discusses portfolio allocation.

Rule # 1 – The Quality Rule

"The single greatest edge an investor can have is a long term orientation"

– Seth Klarman

Common Sense Idea: Invest in great businesses that have a proven long-term record of stability, growth, and profitability. There is no reason to own a so-so business when you can own a great business for a very long time.

Financial Rule: Invest only in stocks with 25 or more years of consecutive dividend increases

Evidence: The Dividend Aristocrats (stocks with 25+ years of rising dividends) have outperformed the S&P500 over the last 10 years by 2.88% per year.[iii]

Rule # 2 – The Bargain Rule

“Price is what you pay, value is what you get”

– Warren Buffett

Common Sense Idea: Invest in businesses that pay you the most dividends so you can increase your cash flow from your investments.

Financial Rule: Rank stocks by their dividend yield.

Evidence: The highest yielding quintile of stocks outperformed the lowest yielding quintile of stocks by 1.76% per year from 1928 through 2013.[iv]

Rule # 3 – The Safety Rule

"The secret of sound investment in 3 words; margin of safety"

– Benjamin Graham

Common Sense Idea: If a business is paying out all their profits as dividends, they will have nothing left to grow the business. When a downturn in the business occurs, they will have to cut the dividend. Invest in businesses that have much higher profits than they do dividend payments so your dividend payments are secure.

Financial Rule: Rank stocks by their payout ratios.

Evidence: High yield low payout ratio stocks outperformed high yield high payout ratio stocks by 8.2% per year from 1990 to 2006.[v]

Rule # 4 – The Growth Rule

“All you need for a lifetime of successful investing is a few big winners”

– Peter Lynch

Common Sense Idea: Invest in businesses that have a history of solid growth. If a business has maintained a high growth rate for several years, they are likely to continue to do so. The more a business grows, the more profitable your investment will become.

Financial Rule: Rank stocks by their long-term revenue growth.

Evidence: Growing dividend stocks have outperformed stocks with unchanging dividends by 2.4% per year from 1972 to 2013.[vi]

Rule # 5 – The Peace of Mind Rule

“Psychology is probably the most important factor in the market – and one that is least understood”

- David Dreman

Common Sense Idea: Look for businesses that people invest in during recessions and times of panic. These businesses will have a relatively stable stock price that will make them easier to hold for the long run.

Financial Rule: Rank stocks by their long-term volatility.

Evidence: The S&P Low Volatility index outperformed the S&P500 by 2.00% per year for the 20 year period ending September 30th, 2011.[vii]

Rule # 6 – The Overpriced Rule

“Pigs get fat, hogs get slaughtered”

– Unknown

Common Sense Idea: If you are offered $500,000 for a $250,000 house, you take the money. It is the same with a stock. If you can sell a stock for much more than it is worth , you should. Take the money and *reinvest* it into businesses that pay higher dividends.

Financial Rule: Sell when the normalized P/E ratio is over 40.

Evidence: The lowest decile of P/E stocks outperformed the highest decile by 9.02% per year from 1975 to 2010.[viii]

Rule # 7 – The Survival of the Fittest Rule

"When the facts change, I change my mind. What do you do, sir?"

– John Maynard Keynes

Common Sense Idea: If a stock you own reduces its dividend, it is paying you less over time instead of more. This is the opposite of what should happen. You must admit the business has lost its safety and reinvest the proceeds of the sale into a more stable business.

Financial Rule: Sell when the dividend payment is reduced or eliminated.

Evidence: Stocks that reduced or eliminated their dividends had a 0% return from 1972 through 2013.[ix]

Rule # 8 – The Hedge Your Bets Rule

"The only investors who shouldn't diversify are those who are right 100% of the time"

– John Templeton

Common Sense Idea: There are 10 stocks on your list each month. They are ranked *in order*. When you go to invest, buy the highest ranked stock of which you own the least of on the list. You will be spreading your bets over different businesses as time goes by. Better yet, you will still be investing in great businesses at fair or better prices.

Financial Rule: Buy the highest ranked stock of which you own the least.

Evidence: 90% of the benefits of diversification come from owning just 12 to 18 stocks.[x]

What Type of Stocks Do the 8 Rules Find?

The business that the 8 Rules of Dividend Investing select have a long history of profitability. They are well-known, familiar household names. This is because *they have been so successful for so long*. I personally feel a sense of relief knowing I am invested in tried and true businesses that have withstood the test of time. I hope you do as well.

To give you an idea of exactly what type of businesses the 8 Rules of Dividend Investing selects, I have included the Top 10 highest ranked stocks for April 2014 below.

List of Top Ten for April 2014

1. Wal-Mart Stores (WMT)
2. Pepsico, Inc. (PEP)
3. McDonald's Corp. (MCD)
4. The Coca-Cola Company (KO)
5. The Chubb Corporation (CB)
6. Exxon Mobil Corporation (XOM)
7. Kimberly-Clark Corpporation (KMB)
8. AFLAC Inc. (AFL)
9. The Clorox Company (CLX)
10. Target Corp. (TGT)

Portfolio Building Guide

Invest in the top ranked stock you own the smallest dollar amount of each month. Over time, you will build a well-diversified portfolio of great businesses purchased at attractive prices.

Examples

Portfolio 1		
Ticker	**Name**	**Amount**
WMT	Wal-Mart Stores Inc.	$ 1,002
XOM	ExxonMobil Corp.	$ -
MCD	McDonald's Corp.	$ -
KO	Coca-Cola Company	$ -
PEP	PepsiCo Inc.	$ -
KMB	Kimberly-Clark Corp.	$ -
CLX	Clorox Company	$ -
CB	Chubb Corp.	$ -
TGT	Target Corp.	$ -
AFL	AFLAC Inc.	$ -

Portfolio 2		
Ticker	**Name**	**Amount**
WMT	Wal-Mart Stores Inc.	$ 4,374
XOM	ExxonMobil Corp.	$ 4,878
MCD	McDonald's Corp.	$ 4,353
KO	Coca-Cola Company	$ 2,952
PEP	PepsiCo Inc.	$ 3,309
KMB	Kimberly-Clark Corp.	$ 4,864
CLX	Clorox Company	$ 6,660
CB	Chubb Corp.	$ 2,367
TGT	Target Corp.	$ 2,818
AFL	AFLAC Inc.	$ 6,243

- If you had portfolio 1, you would buy ExxonMobil, the top ranked stock you own least.
- If you had portfolio 2, you would buy Chubb Corp., the top ranked stock you own least.

If you have an existing portfolio, switch over to the Sure Dividend strategy over a period of 20 months. Each month, take 1/20 of your initial portfolio value, and buy the top ranked stock you own the least (as per the examples above).

When you sell a stock, use the proceeds to purchase the top ranked stock you own the least. Reinvest dividends in the same manner.

This simple investing process will build a diversified portfolio of high quality dividend stocks over a period of less than 2 years. Your savings will be invested only in highly ranked stocks by buying in over a period of time. Further, higher ranked stocks will get proportionately more investment dollars as they will stay on the rankings longer. You will build up large positions in the highest quality stocks.

Investing is a Marathon, not a Sprint

The system and method above will not work if you do not approach it with the correct mindset. There will be months of underperformance versus the market (especially during bull markets). Not every investment will turn out as you want it to. It is *critical* to keep an even keel and focus on long-term results.

"Absent a lot of surprises, stocks are relatively predictable over twenty years. As to whether they're going to be higher or lower in two to three years, you might as well flip a coin to decide"

- Peter Lynch

Do not think of your stocks as bits of data on a computer that bounce up and down in value every day. They are fractional ownership shares of great businesses. When you own McDonald's stock, you own a little bit of each McDonald's in the world. You make a fraction (a very tiny fraction) of a penny every time a Big Mac sells.

You would not sell your house because someone came in and offered you less money that it is really worth, so why would you do that with a great business? Holding great businesses for long periods is a fantastic way to compound wealth.

"If the job has been correctly done when a common stock is purchased, the time to sell it is – almost never."

- Philip Fisher

The advantage to holding businesses as long as long as they retain a strong competitive advantage and continue to reward shareholders is you minimize frictional costs. You don't pay taxes on businesses you hold. The tax savings are 'rolled over' into your investment; they continue to compound. You also minimize trading costs, which eat into profits of high transaction strategies. Further you minimize the amount of time spent agonizing over what to buy and what to sell, all while giving your great businesses the opportunity to grow over a long period of time.

"When we own portions of outstanding businesses with outstanding managements, our favorite holding period is forever."

- Warren Buffett

Conclusion

Investing can be complicated and time consuming, but it does not have to be. There are 3 keys to wise investing:

Invest in high quality dividend stocks

Invest with a systematic plan

Invest for the long-run

Sure Dividend's monthly newsletter provides our members with the Top 10 stocks based on the 8 Rules of Dividend Investing each month. You can benefit from our newsletter by investing in high quality growing dividend stocks in as few as 5 minutes a month. Give yourself peace-of-mind knowing you invest in high quality businesses for the long-run. Invest with a plan.

See www.suredividend.com/subscribe for more info about our free 30 day trial and $9 per month pricing. Use the coupon code EBOOK to receive 50% off your first month after your trial period.

Sources

The information in this eBook comes from the sources below. They are full of relevant information for Dividend Investors.

If you know someone who may find the information in this eBook useful, please share it so they can benefit as well. Thanks for reading.

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[i] Reason to Consider Dividend Paying Stocks by Fayez Sarofim & Co, Page 6

[ii] Graph from The Case for Index Fund Investing by Vanguard, Page 8

[iii] S&P 500 Dividend Aristocrats Factsheet, February 28 2014, page 2

[iv] Dividends: A Review of Historical Returns by Heartland Funds, page 2

[v] High Yield, Low Payout by Barefoot, Patel, & Yao, page 3

[vi] Rising Dividends Fund, Oppenheimer, page 4

[vii] S&P 500 Low Volatility Index: Low & Slow Could Win the Race, page 3

[viii] The Case for Value by Brandes Investment Partners, Page 2

[ix] Rising Dividends Fund, Oppenheimer, page 4

[x] Frank Reilly and Keith Brown, Investment Analysis and Portfolio Management, page 213