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Stock Price Appreciation

Why Dividends Matter Series

CRAWFORD
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Looking for a way to invest where the odds are in your favor, and in which you are, in our opinion, almost assured of investment success?

We believe we have one, but in order to make it work you will have to be a patient, long-term investor in high-quality stocks. Furthermore, it's our belief you will be better off if you ignore the shorter-term issues of the economy or markets. Investors cannot totally ignore the realities of the world around them, but with this approach one will be better served to leave out the "tinkering" that comes with trying too hard to succeed in the stock market. One of the characteristics of this approach is its simplicity. Anyone can understand it; perhaps this is why so few embrace it.

To explain this method of investing, let's start with financial theory. It states that the value of any asset is determined by the present value of all of its future cash flows. In the case of stocks, those future cash flows are dividends, the tangible return that an investor receives over the life of the asset. Most investors focus on earnings, not dividends, but keep in mind that earnings are not returned to stockholders; dividends are. We do not underestimate the value of earnings, for we recognize that they are the stuff of which dividends are created.

Taking financial theory further, the value of a stock is not only determined by the earnings and the dividend, but also by what investors are willing to pay for the earnings and dividends (price-to-earnings ratio). The dividend is therefore one of three elements that creates value in a stock. If the dividend increases, theoretically, the value of the stock should increase, all things being equal.

Three elements create value:

- Company earnings
- Dividends
- Multiple on earnings and dividends (P/E and Dividend Yield)

A consistently rising dividend can be a factor in driving the price of a stock upward. In fact, in our opinion it may be the most powerful factor. We like to call a rising dividend the "silent factor" in the portfolio. Its impact over the short term is minimal, and therefore goes unnoticed by many. But the slow, consistent buildup of dollars being thrown off by the dividend seeps into the price of the stock over time. Jeremy Siegel, noted author, professor, and market commentator says it well: "The importance of dividends in generating stock returns is not just historical happenstance. Dividends are the crucial link between corporate profits and stock prices." Yes, earnings are the stuff of dividends, and rising dividends are the stuff of price appreciation.

How should one look at this type of investing? As stated earlier, it requires patience, discipline, and a longer time horizon. It is not for the investor who requires "action" or who is trying to "beat the market" every year. It is tax efficient, for the turnover is obviously very low, and it takes time for the dividends and dividend growth to positively affect the prices of the stocks. It is our belief that it is a less risky approach to investing because of its focus on very high-quality companies and its dependence on dividends. Dividends are real and known, therefore any dividend-based strategy is likely to be less chancy than one based on "growth" or "concepts."

We started this paper with the claim that we have an investment approach that is almost assured of success if employed properly. That is a very strong claim, but we stand by it. In our opinion, steadily rising dividends in high-quality companies are likely to eventually drive the prices of these stocks upward. Dividends, especially those that increase on a consistent basis, have attractive features, not the least of which is the ability to provide appreciation in the value of a stock over time.