

Investor

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Helping you make informed investment decisions for your future

Easing back into the markets can pay dividends



Stocks have staged a convincing rebound this year, with Canadian equities advancing an impressive 46% from the low point on March 9, 2009 to the end of August. Investors are clearly beginning to re-enter the market, albeit with a sense of caution as the volatility of 2008 and early 2009 still remains a fresh memory.

Despite the strong rally that’s already taken place this year, we believe there is still plenty of upside potential remaining. Indeed, we may be entering a protracted period of recovery as global economic growth resumes and markets around the world regain their strength.

Figure 1 shows how the Canadian equity market has been able to rebound 12 months and 24 months after a variety of significant market losses over the past 35 years.

Investors who wish to participate in the upside potential of the market—while still remaining conservative in their approach—may find that dividend-paying equities offer the ideal balance of opportunity and risk management.

A brief history of dividends

A dividend is a cash payment from a company’s earnings, distributed to shareholders. In other words, dividends are an investor’s share of a company’s profits.

Dividends are generally paid by large and stable companies with a track record of turning a profit year after year.

Examples of Canadian companies that are known for their stability and consistent dividend payouts include BCE Inc., Enbridge Inc., and the major banks.

Dividend-paying shares are unique, because they offer investors the opportunity to participate in the market’s long-term growth, while also collecting dividend income each quarter. Taken together, this combination of growth and income has historically led to superior long-term performance and a cushion against market volatility.

Superior long-term performance

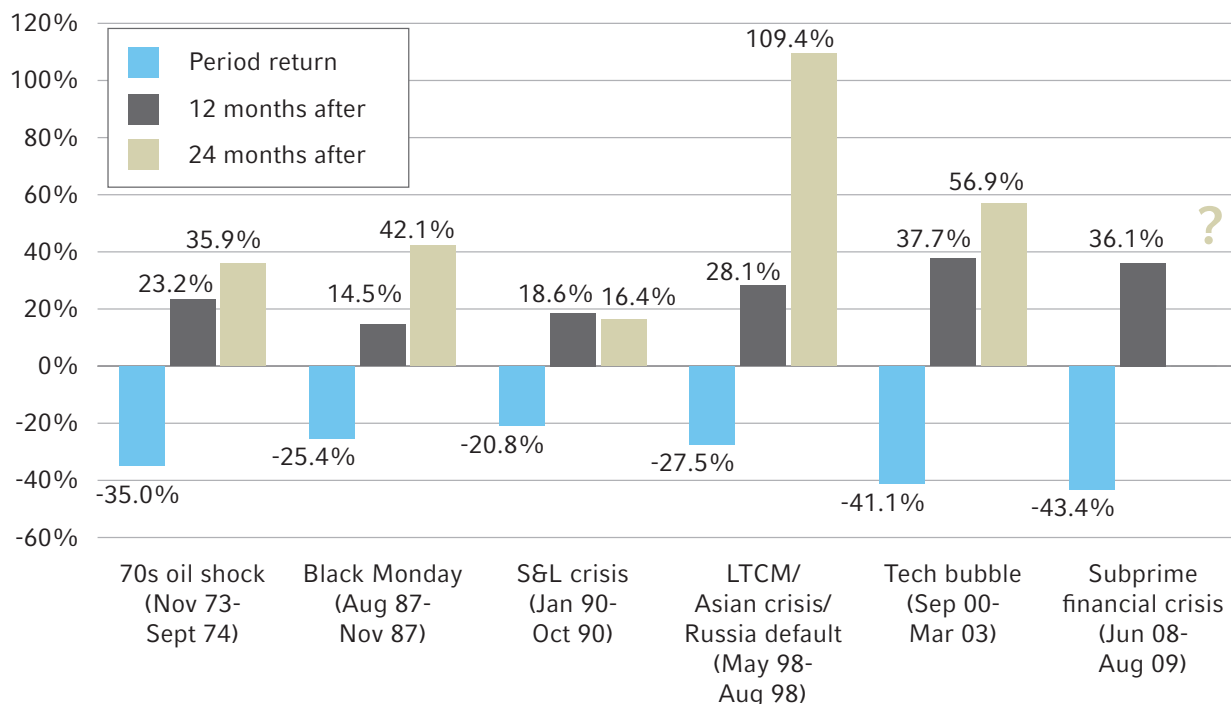
Figure 2 shows how an index comprised of “Dividend Growers” (stocks from the S&P/TSX Composite Index that have historically increased their dividends) outperformed the S&P/TSX Composite Index by nearly 31% over the past 10 years.

During this period, a \$100,000 investment in the “Dividend Growers” index would have grown to \$260,460, which is \$62,627 more than if the same amount was invested in the S&P/TSX Composite Index.

Why now is the time to invest in dividends

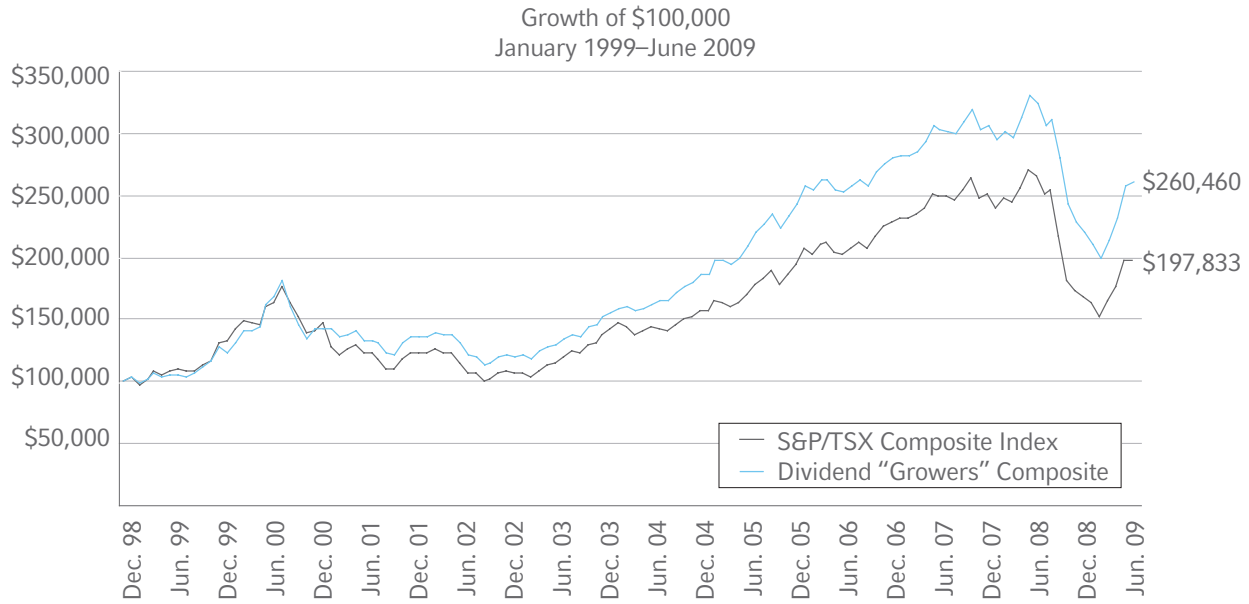
While it is encouraging to see the markets bounce back, it is not surprising that most conservative investors, such as retirees or those preparing for retirement, would prefer to tiptoe back into the market rather than dive in.

Figure 1: S&P/TSX Composite Index Returns after steep market declines



Source: Russell Investments Canada Limited, S&P/TSX Composite Index

Figure 2: "Dividend Growers" vs. S&P/TSX Composite Index



Source: FactSet, Russell Investments Canada Limited.

The Dividend "Growers" Composite represents equities in the S&P/TSX Composite Index that increased dividends over the previous 12 months.

However, becoming overly conservative can itself be a risky proposition. Russell research¹ has demonstrated that many of us will accumulate the majority of earnings income from post-retirement returns, and it is necessary to maintain some level of equity exposure in order to do so. A diversified selection of dividend-paying stocks can assist in gaining this all-important equity exposure while still maintaining a relatively conservative risk profile.

Here are some of the key reasons why dividends make sense:

- › **Income and growth:** Dividend-paying stocks offer steady dividend income, plus the chance to benefit from share price appreciation.
- › **Safety:** A steady stream of dividends can provide a valuable "cushion" to support the share price—even in volatile markets.
- › **Tax-efficiency:** Dividends are taxed at a preferred rate relative to interest income, which can result in higher after-tax income for retirees and others who rely on their investments for income.
- › **Stability:** Dividends are generally paid by well-established, stable companies. Even in recessionary times, many dividend-paying companies remain profitable and continue to share their profits with shareholders in the form of dividends.

The power of dividends was reaffirmed during the recent economic downturn. Despite the challenges of the credit crunch, Canadian banks revisited efficiency targets and reduced overhead where necessary in order to maintain their decades-long track record of paying reliable dividends.

The passing of the financial crisis has also removed a lot of risk and uncertainty from corporate balance sheets. As a result, today's money managers have a much clearer picture of companies' free cash flow positions, which enables them to confidently identify companies with solid dividend prospects.

Consider a professionally managed dividend fund

A dividend fund can be an especially effective investment for anyone seeking a diversified, conservative source of growth potential and tax-effective income. Dividend funds are attractive because they are professionally managed and tend to have a lower risk profile than individual dividend stocks, since portfolio risk is spread among numerous dividend-paying companies.

Russell Canadian Dividend Pool offers all the benefits of a diversified dividend fund, plus an additional measure of opportunity and protection: it is subadvised by two of the nation's leading Canadian equity investment managers.

¹Russell Research: The 10/30/60 Rule: Where Do DC Plan Benefits Come From? It's Not Where You Think; Matt Smith & Bob Collie, January 2008

- › *Goodman & Co. Investment Counsel Ltd. (Goodman):* Goodman focuses first on finding high-quality Canadian companies, and second on targeting opportunities for dividend growth. They seek out companies with undervalued assets, unrecognized growth potential, and attractive long-term potential.
- › *Foyston, Gordon & Payne Inc. (Foyston):* Foyston offers a complementary approach that primarily focuses on identifying companies with the opportunity for dividend growth. They concentrate on out-of-favour stocks with low valuations and the potential for capital appreciation over time.

These proven money managers have the knowledge and resources to identify the firms with the potential to sustain and grow their dividends over time—such as those highlighted in the “Dividend Grower’s” index.

Russell continually monitors the performance of each manager to make sure they consistently generate income and manage risk on behalf of fund investors.

Talk to your advisor

Dividend-paying investments can be an excellent vehicle for investors who want to:

- › Generate income and potential capital gains while decreasing risk
- › Invest in companies that show a history of profitability
- › Participate in the potential market recovery

Talk to your advisor about how you can use dividends to safely ease back into stocks and position your portfolio to take advantage of this market opportunity. It’s a conversation that could pay dividends in the long run.

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