



## Experts divided on dividends

### Income trust rules renew interest in stocks that pay

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SPECIAL TO THE STAR

When the federal government stunned the markets in October with the decision to end the special tax treatment for income trusts, an old star re-emerged, dividend-paying stocks.

In the great sell-off of income trusts following Ottawa's announcement, much of that money flowed into stocks notable for their rich dividend payouts, most notably the financial sector led by Manulife Financial Corp.

For years tagged as widows' and orphans' stocks, dividend-paying equities are prized for the promise of price appreciation (like regular stocks), combined with their cash distributions.

That does not necessarily mean that dividend stocks are superior to non-dividend-paying stocks or that companies known for reliably doling-out disbursements are superior to companies that do not.

"There is a folklore around dividends," said David Bruce, a financial adviser and portfolio manager with ScotiaMcLeod.

"There are many people who espouse that companies which pay dividends are in stronger shape because they can afford to pay the dividends and also because the money won't be wasted by management."

The cash-distribution nature of dividend stocks is what makes them cherished by investors who count on their income. Those dividends also cause shareholders to view those stocks differently.

"It's the total return that's important," said Bruce, offering up an example of two stocks, both generating an annual return of 10 per cent, but with one including a 3 per cent dividend in that return.

The most tax-efficient stock to hold is the non-dividend paying stock because taxes on the gains are deferred until the shares are disposed of.

In Canada, the dividend-paying club is dominated by banks and insurance companies. Their results have positively skewed overall returns for dividend stocks generally.

Over the past decade ended July 2006, dividend-paying issues outperformed the S&P/TSX composite index, while non-dividend-paying companies lagged both dividend issues and the broad index, according to an internal report used by staff at the Toronto Dominion Bank.

"You want to look at not just dividend-paying stocks, but if you can find a company that is paying a good dividend but is also increasing its dividend, that is the sweet spot," said Kathryn Del Greco, senior investment adviser with TD Waterhouse Private Investment Advice.

By that measure, the stars are the bank stocks. She highlights Royal Bank of Canada, which has raised its dividend 20 times over the past 10 years, rising from 8 cents to 40 cents last year.

Similarly, the Bank of Nova Scotia has upped its quarterly dividend from 8 cents a decade ago to 39 cents last year.

Besides raw performance, TD advises its clients to make dividend stocks a key part of their portfolio because the discipline of distributing cash regularly to shareholders makes them different.

"Dividend-paying companies tend to be representative of the companies that have got the strongest financial balance sheets," said Del Greco.

"Once a company starts paying a dividend, it is extremely rare that it would cut its dividend. For a company to cut its dividend would be disastrous to their credibility on the Street, and for their

shareholders."

She contrasts that with the far different mindset of income trusts, which might offer a higher yield than dividend stocks, but are quick to cut distributions in tough times.

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