The Dogs of the Dow and Dividend Dependability

Last month, I provided you with Young Research’s dividend dependability ratings for the 30 blue-chip Dow companies. Young Research’s Dividend Dependability ratings use a combination of fundamental and qualitative factors to rate the dividend safety of each Dow component.

Every company in the Dow pays a dividend and compared to the average dividend paying company, Dow companies have above average dividend safety, but that didn’t prevent General Electric from cutting its dividend last year, or GM slashing its dividend while still a Dow component, or Eastman Kodak from cutting its dividend or, or, or.

High yielding Dow stocks are tempting to income investors. You are often talking about high yields on some of America’s best companies. In a low yield environment, a 3%+ dividend yield on a blue-chip stock has inherent appeal. But if you are retired or soon to be retired, and you rely on your dividend income to fund expenses, a dividend cut could put a dent in your retirement income. That is especially true if you follow one of the more popular Dow dividend investing strategies—The Dogs of the Dow.

The Dogs of the Dow is popular partly because it has worked over long periods of time, but also because it is a simple strategy to follow. All an investor must do is rank the 30 Dow stocks by yield at the end of each year and buy the 10 highest yielding stocks in equal amounts. The stocks are held for the balance of the year, and at the start of the following year the process is repeated.

The problem with the strategy is that the highest yielding stocks may be at most risk of a dividend cut. A high yield sometimes means a stock is out of favor (that's what Dogs of the Dow investors are hoping for), but it can also signal that the dividend is at risk. How do you avoid the problem?

That's where Young Research's Dividend Dependability ratings can help you. The highest yielding stocks in the Dow to start 2018 are Verizon, IBM, Pfizer, Exxon, Chevron, Merck, Coca-Cola, Cisco, Procter & Gamble, and General Electric.

Six of these stocks fall into the bottom third for dividend dependability. Those stocks include IBM, Exxon, Chevron, Merck, Cisco, and General Electric. The four that rate in the top twenty for dividend dependability are Verizon, Pfizer, Coca-Cola, and Procter & Gamble.

If you want to invest for yield, but reduce your risk of owning a company that may cut its dividend, you can replace the six Dogs of the Dow stocks that rank in the bottom third for dividend dependability with the highest yielding stocks from the remaining stocks that rank in the top two-thirds for dividend dependability.

Based on current yields, those stocks include Intel, Johnson & Johnson, McDonald's, Boeing, Travelers, and United Technologies. Add those to positions in Verizon, Pfizer, Coca-Cola, and Procter and Gamble, and you are looking at an average yield of 2.8%. The average projected dividend growth for this group of stocks in 2018 is 6.3%. Compare that to the 10 stocks in the Dogs of the Dow that have an average yield of 3.4% and projected dividend growth of 3.9%. You give up 0.60% in yield for the comfort of more dependable dividends and better dividend growth prospects.

Not a bad trade for investors who rely on regular dividend income.

For more on dividend dependability, read parts one, two, and three of my series on the subject.