# Dividend Growth – A Stealth Growth Strategy Using High-Yield Stocks

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## The Problem

- We live in a era when it is harder than ever to earn a decent investment return.
- At the same time, traditional pensions are fading away, and more and more individuals are and will be dependent on their retirement savings to fund their lifestyles after they stop working.
- For many nearing retirement, the amount they have accumulated is not enough and they are entering the investment markets with the goal of growing their savings totals.
- I focus on developing dividend centric strategies that will work to build and sustain a portfolio for decades of retirement.

## The Problem: Part II

- Losing money in the market is easy – investing for a good total return over time is very hard!
- 10-year Treasury yields 2.8%
- CD's yield 2.5% max
- Two major market crashes since 2000 and three market corrections since late 2015 show that market timing to produce steady gains will most likely not work.
- With the stock markets at record highs and P/E ratios at the top of the historic range, overall market returns are likely to be well below the 9% per year long term average.
- A different strategy is required.

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- I teach and make stock recommendations using a higher-yield dividend stock strategy.
- The focus is on building a growing income stream.
- Share prices are not the investment focus, however the strategies naturally lead investors to buy low and sell high.
- The goal is to have an investment system that works through the market cycles.

There are two approaches to dividend investing:

- Dividend Growth
- High Yield

## Traditional Dividend Growth Strategy

- Buying shares in blue chip or near blue chip stocks with long histories of annual dividend increases.
- "Dividend Aristocrats" and "Dividend Achievers“
- These companies have decades long dividend increase histories. Boards of directors don’t want to break the growth streaks.
- Typical yields are 2% to 4%
- The strategy will build wealth, but it can take a long time, as in decades

## Typical High Yield Investor Strategy

- Buy companies with pass-through tax structures – REITs, MLPs, BDCs.
- Wide range of yields: 2% to over 20%.
- Most investors go for the higher yield choices.
- High cash flow rate to investors can be used for current income or in a reinvestment strategy.
- A portfolio can be built with attractive current yield and growing dividends.

## Problems With High Yield Strategy

- Pass through structures require large portion of net profits/cash flow to be paid as dividends.
- Growth oriented companies need access to debt and equity markets at reasonable rates.
- Results more varied on a company by company basis.
- Investors may focus too much on yield, and not on underlying business and cash flow.
- Potential for dividend cuts and big share price drops are higher.
- Traditional stock metrics typically do not work.

- I have developed a hybrid strategy based on a simple math idea.
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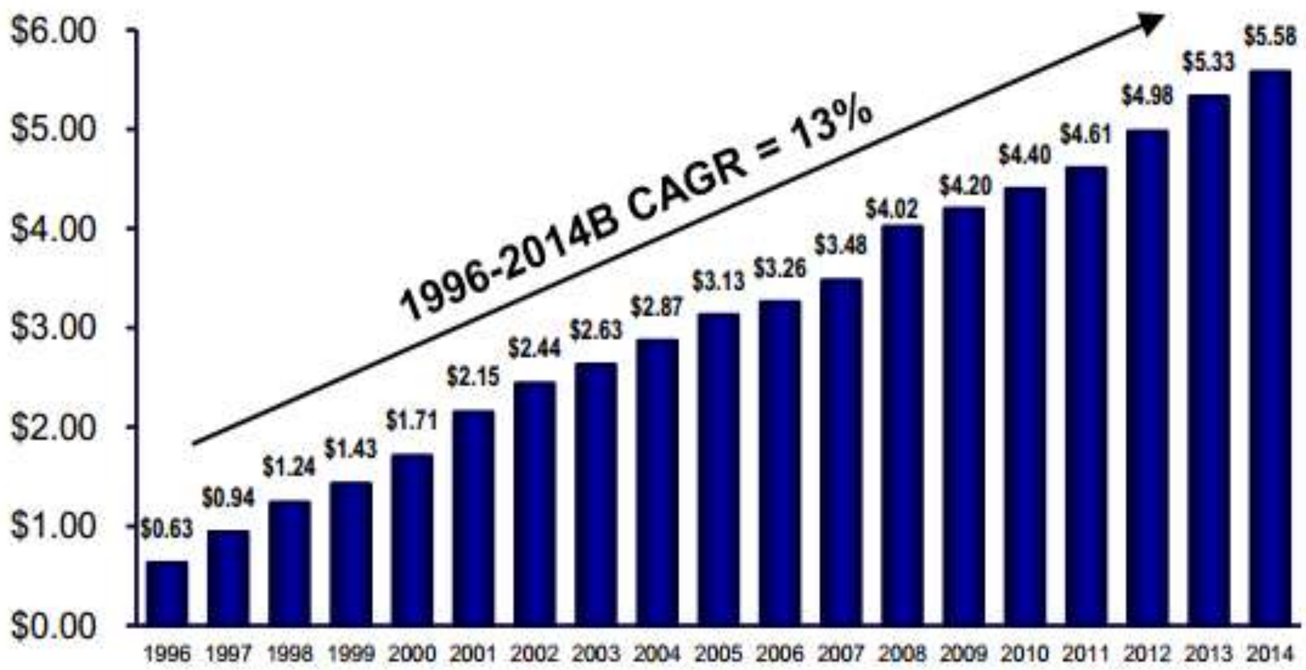
- The total return from an income stock over time will be the average yield plus the average annual dividend growth rate.
- Dividend earnings growth is the key to sustainable total returns through market up and down cycles.
- My strategies combine manufactured dividend growth with organic growth.
- Here are some examples of great returns from organic growth.

# Kinder Morgan Partners

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## Kinder Morgan Partners

- KMP IPO Feb 1997 at $10.62 per unit
- Initial annual dividend rate was $0.94
- The dividend grew at a 13% annual compound growth rate for 18 straight years
- The company was bought out in November 2014 at $103 per share
- Final dividend rate: $5.58
- Total dividends earned in 17 ½ years: $58.66 per share
- 1,000 shares purchased at IPO for $10,062 returned $58,660 in dividends and $103,000 in share value.
- Average annual return: 16.9%

## Simon Property Group Inc. (SPG)

- Seven years ago, SPG had a $2.40 annual dividend and a $70 share price.
- The dividend has been increased 21 times since 2010 and is now $8.00 per share per year.
- The shares are now at $180, off a 2016 high of $227.
- SPG has returned 12.4% per year compounded, turning $10,000 eight years ago into $26,258 today.
- 11.1% five year averaged dividend growth rate. 8.0% 10-year average dividend growth.

## Balance Dividend Growth Income Stocks with High-Yield

- Higher yield stock typically don't have much dividend growth.
- You can manufacture dividend income growth using dividend reinvestment.
- Compound growth becomes a powerful force as dividend yields increase.
- Hi Yield stocks come with a different set of risks.

## Compound Growth Illustrated

- The low interest rate environment of the past decade has pushed compounding income for growth out of the investing publics mindset.

- My Dividend Hunter recommended stocks list has a average yield of over 8%.

- A $100,000 portfolio of high yield stocks will grow to $147k in five years and $216k in 10 years at 8% compounded.

- More importantly and predictably, portfolio income will grow from $8k to 17k in ten years.

## Risks of High Yield

- Individual stocks have high yields to price in market expectations of a dividend reduction.

- Two potential outcomes:
  - The market is right and the dividend will be reduced
  - Or the market is wrong and investors will reap an above average yield.

- Most of these companies most or choose to pay out a high (90% or more) percentage of free cash flow as dividends.

- If cash flow per share is not sustained, dividends won't be either.

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## Risks of High Yield - continued

- Many of these companies need to access the capital markets – equity and/or debt – to raise capital for growth or even to sustain revenue and cash flow

- Dividend yield is the cost of equity capital, so a share price crash can put the brakes on a business model.

- A couple of examples:
- Uniti Group (UNIT)
- Dominion Midstream Partners (DM)

## Dividend Growth Strategy for Total Return Step 1: The Hard Part

- Build a list of companies that have or are forecast to generate sustainable high yields or above average dividend growth rates.
- 
- I target 8% to 15% annual total returns as calculated by yield plus dividend growth rate.
- 
- Most qualified companies with higher yields will be pass-through entities: REITs, MLPs, and other publicly traded partnerships.

- I have about 300 stocks I follow to keep my newsletter recommendations lists at 35 to 40.

## Dividend Growth Strategy for Total Return Step 2

- Review past dividend history. Recent dividend cuts are sign to avoid. Dividend growth is a big positive.
- Review a company's business operation to understand how revenues and cash flows are generated. Each company has its own story to tell.
- Calculate or figure out how each company reports free cash flow per share. This is not EPS.
- Review the cash flow (AFFO, DCF, etc.) coverage of recent dividends.
- You want a handle on how stable are dividend payments.

## Dividend Growth Strategy for Total Return Step 3

- Put together your own estimate of forward cash flow sustainability and potential dividend growth.
- 
- Management guidance is usually provided for the current year.
- 
- Understand the sources of future growth from the long term plans provided by each company.

## Dividend Growth Strategy for Total Return Step 4

- Make a table/spreadsheet to rank stocks by current yield and projected growth.

- Compare similar companies for better combinations of yield plus growth potential. Examples:
- STWD vs BXMT
- EPR vs O
- PSXP vs VLP

- Build a portfolio with focus on diversity of industries. Higher yield stocks fall into a few categories, so you must be creative when thinking about diversification.

- Limit the number of stocks you own to force a search for quality.

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## Dividend Growth Strategy for Total Return Step 5

- With each quarterly earnings review individual company results.
- Cash flow per share growth (AFFO, DCF) against your forecasts.
- Changes in management manner or guidance.
- These steps include reviewing results of stocks you don’t own, looking for new investment candidates.

## Portfolio Maintenance

- Take partial profits when you get above guidance share gains.
- Reinvest dividends and sale proceeds to generate a higher portfolio yield.
- Track your results by quarterly dividend income. This is my primary measurement of strategy success.
- Buy, buy, buy when the market corrects.
- Place your focus on portfolio management vs. individual stock price movement.

## Change Your Mindset About Share Prices!

- Falling share values are an opportunity not a curse.
- Buy low to earn a higher yield and larger dividends.
- Initial stock selections are based on your cash flow per share research and not influenced by share prices.
- Take a profit if one of your shares moves rapidly higher, and the yield no longer make sense.
- For example, I recommended selling Ventas, Inc. (VTR) in early 2015 when the share price was above $80 and the yield below 4%. Recommended buying again later that year, with share value at $55 and yield above 5%. Sold again after 35% gain.

# Thank You!

## Some Income Stock Recommendations

- TPG Real Estate Finance Trust (TRTX). 2017 IPO. Exciting dividend growth potential. 8.5% yield.
- PermRock Royalty Trust (PRT). ≈9% to 10% yield from Permian oil.
- Macquarie Infrastructure Co. (MIC). 8.7% yield. This is an exception to the avoid dividend cutters rule.
- CNX Midstream Partners LP (CNXM). 6.5% distribution yield and 15% annual growth with quarterly increases.
- Virtus InfraCap U.S. Preferred Stock ETF (PFFA) is a new ETF combining preferred stock yields and covered call income. Monthly dividends and an 8% yield.

## Questions

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