

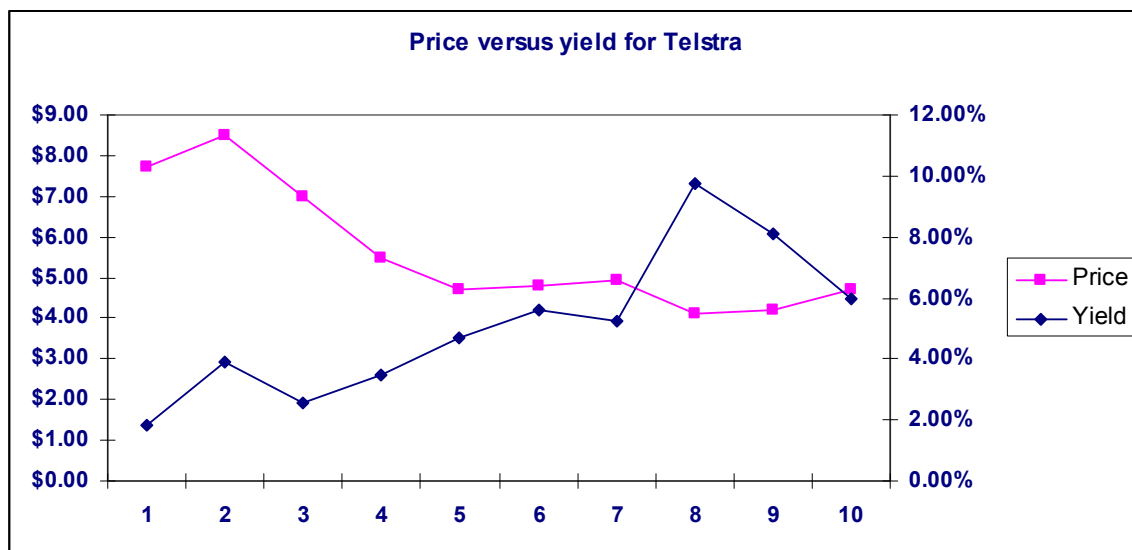
High yielding stocks are defensive safe havens – myth or fact?

We Australian's love our dividend payments, so much so that it is not uncommon to come across investors that won't even consider buying a stock unless it pays dividends. The relative size of dividend payments is commonly measured in terms of the yield, which, like an interest rate on a bank account, measures the percentage income that a stock could generate for the investor via dividend: The higher the yield, the stronger the dividend income relative to your initial investment.

What does this mean for investors?

In tough market conditions high yielding stocks have traditionally been regarded as defensive safe havens, with the income from dividend payments insulating against any share price weakness. As a result, high yielding stocks have a reputation for outperforming in rough markets. However, this reputation is largely unfounded and has not necessarily been the case in the current market turmoil.

Below is a graph comparing the end-of-year share price of Telstra compared to its yield since the year 1999.



Price versus yield since 1999 including special dividends. Source: wise-owl.com

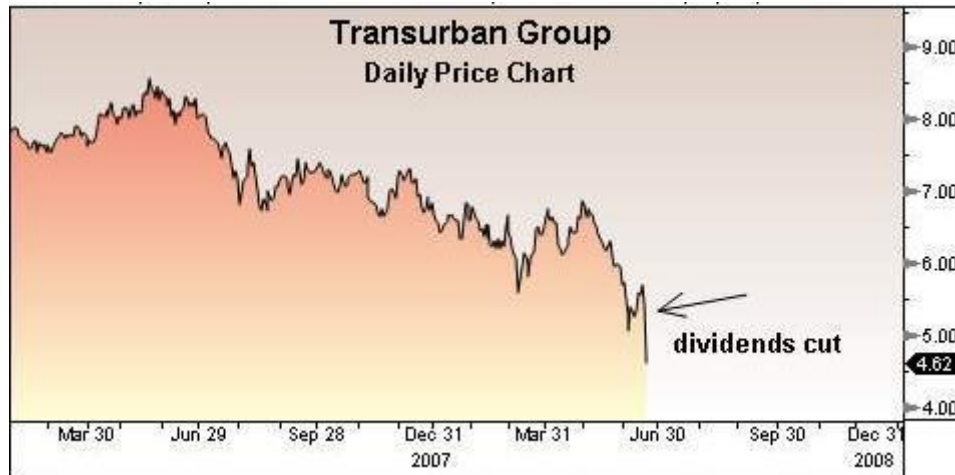
Although the yield has been rising over the years, it has not helped the share price, as many suffering long-term holders of the Big Telco would know!

Why has the high yield not helped the stock outperform?

Although yield is important, especially for blue chip stocks, dividends do not compare to capital growth. Ultimately, the fundamentals of any stock will guide future share price performance, and not yield. There is also the added risk that if a company is not continuously growing, management may decide to cut dividend payouts. In these cases, the stock price often plummets as investors vote with their feet.



We have recently seen an example of this in Transurban whose share price got slashed 15% as management cut dividends by 60%.



Cut dividends cut a deep wound in the share price of TCL. Source: wise-owl.com, Bloomberg

This is not to say there aren't great dividend yielding stocks out there, but at the end of the day the fundamentals must be solid for the underlying growth of the company.

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