



## The Folly of Chasing Dividend Yield

by John Scruggs

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Since the “great recession,” interest rates have been considered low by historical standards, and it’s not just a recent phenomenon. Real interest rates and inflation have been in decline since the 1980s. While this trend has been a potential boon to borrowers, it’s been a source of irritation to savers and retirees trying to live on the income from their investment portfolios. What’s an investor to do? For some, the temptation to chase yield is strong. Dividend-paying stocks offer more attractive yields. But the attraction can be illusory. Investors should focus on total returns rather than dividends.

### Dividend Irrelevance

Research by Nobel Prize winners Merton Miller and Franco Modigliani showed that dividend policy should have no effect on stock prices or expected returns in perfect capital markets.<sup>1</sup> If a stock’s dividend is too low to meet income needs, an investor can sell some shares to create a “homemade dividend.” Likewise, if a stock’s dividend is too high, investors can use some of the dividend to buy more shares. Since its publication in 1961, the Miller-Modigliani “dividend irrelevance theorem” has framed the debate on dividend policy.

Dividend irrelevance is an elegant theory, but does it hold up in practice? Let’s take a look at the historical record. I examined monthly returns on U.S. stocks for the period July 1927 to October 2016, looking at four investment strategies:

1. No-dividend stocks
2. Low-yield stocks
3. Mid-yield stocks
4. High-yield stocks

Each strategy is represented by a portfolio that is rebalanced once per year. Each July, individual

stocks are sorted into one of four equally-weighted portfolios based on their dividend yield at the end of the previous December.

The figure below plots annualized average total and price returns for the four strategies. Total returns are the sum of price returns and income returns. As you can see, high-yield stocks earn the same total return, on average, as low-yield or non-dividend-paying stocks. This is consistent with the Miller-Modigliani theoretical prediction that dividend policy is irrelevant.



Source: Professor Ken French, Data Library, Dartmouth University Tuck School of Business, 2017

The average price returns are higher for portfolios with lower-dividend yields. This is expected, but not meaningful. The owners of low-yield stocks receive their returns in the form of higher capital appreciation, on average, to make up for the lower average income returns.

At Loring Ward, we construct our model portfolios based on the risk and expected total return of asset classes. As suggested by theory, we do not chase dividend yield. Tilting toward dividend-paying stocks may increase portfolio risk (by reducing the benefits of diversification) without potentially offering any improvement in portfolio expected return. Periodically redeeming fund shares to provide income is a perfectly natural part of retired life. Financial advisors can help investors with these decisions.

<sup>1</sup>Miller, M., & Modigliani, F., 1961, “Dividend Policy, Growth, and the Valuation of Shares.” *The Journal of Business* 34, 411-433. In theory, assuming perfect capital markets implies no transaction costs, no taxes, and no information costs.

## Leprechauns: Facts About the Irish Trickster Fairy

By Benjamin Radford, Live Science

Leprechauns are a type of fairy, though it's important to note that the fairies of Irish folklore were not cute Disneyfied pixies; they could be lustful, nasty, capricious creatures whose magic might delight you one day and kill you the next if you displeased them.

Leprechauns are often described as wizened, bearded old men dressed in green (early versions were clad in red) and wearing buckled shoes, often with a leather apron. Sometimes they wear a pointed cap or hat and may be smoking a pipe.

In their book “The Element Encyclopedia of Magical Creatures,” John and Caitlin Matthews trace leprechaun legends back to eighth-century legends of water spirits called “luchorpán,” meaning small body. These sprites eventually merged with a mischievous household fairy said to haunt cellars and drink heavily.

Other researchers say that the word leprechaun may be derived from the Irish leath bhrogan, meaning shoemaker. Indeed, though leprechauns are often associated with riches and gold, in folklore their main vocation is anything but glamorous: they are humble cobblers, or shoemakers. Shoemaking is apparently a lucrative business in the fairy world, since each leprechaun is said to have his own pot of gold, which can often be found at the end of a rainbow.

According to Irish legends, people lucky enough to find a leprechaun and capture him (or, in some stories, steal his magical ring, coin or amulet) can barter his freedom for his treasure. Leprechauns are usually said to be able to grant the person three wishes. But dealing with leprechauns can be a tricky proposition.



The leprechaun plays several roles in Irish folklore; he is principally a roguish trickster figure who cannot be trusted and will deceive whenever possible. In her encyclopedia “Spirits, Fairies, Leprechauns, and Goblins,” folklorist Carol Rose offers a typical tale of leprechaun trickery “concerning a man who managed to get a leprechaun to show him the bush in the field where his treasure was located. Having no spade [shovel], the man marked the tree with one of his red garters, then kindly released the sprite and went for a spade. Returning almost instantly he found that every one of the numerous trees in the field sported a red garter!”

In the magical world, most spirits, fairies and other creatures have a distinctive sound that is associated with them. Some entities — such as the Irish fairy banshee and the Hispanic spirit La Llorona — are said to emit a mournful wail signifying their presence. In the case of the leprechaun, it's the tap-tap-tapping of his tiny cobbler hammer, driving nails into shoes, that announces they are near.