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Key Investment Themes for 2012: Income-Oriented Equity

Hello, my name is Robert McConnaughey and I'm the head of equity for Columbia Management Investment Advisers. I joined the firm in 2002 as director of fundamental equity research and have been a member of the investment community since 1993. I wanted to spend a few moments describing our current view on income-oriented equities.

Why are income-oriented equity securities a key investment theme for 2012?

The evidence is clear that dividends have always been a crucial part of total returns and dividend payers have significantly outperformed their non-dividend-paying peers over time. Couple those higher returns with the lower volatility that comes with the dividend-paying class vs. broader equity markets and it makes a clear case for the power of dividend investing.

There is no more elegant single gauge of corporate health and strong governance practices than the ability and willingness of corporations to make recurring payments of cash to shareholders in the form of dividends. Income from bonds is well and good, but equity dividends have one key advantage: properly managed, they can grow over time.

Why dividend-paying stocks today?

We have been advocates for a significant allocation of one's equity portfolio to dividend-paying stocks for a long time. We believe now is a particularly good time for three main reasons.

First, given the avalanche of funds flows toward the perceived safety of bonds, the relative attractiveness of dividends is at historically high levels. Compared to Treasuries, or even high yield debt, yields on stocks are relatively about as cheap as they have been in decades.

Second, we like what we see in corporate balance sheets. The collective consumer balance sheet is still in rough shape and government balance sheets are not only extremely stressed but also running huge ongoing deficits. In stark contrast, corporations are awash in cash and are generating historically high free cash flow yields.

Given current payout ratios that are well below historic average, we think the backdrop is set for a period of solid dividend growth. This brings us to another interesting feature of equity income vs. income from bonds. Equity income strategies have an inherent inflation capture through growth in dividends and the potential for capital appreciation.

Third, demographics currently favor dividends. Our society is not only aging, but the recent financial turmoil has reinforced the need for reliable income for people in or nearing retirement. Concerns about the solvency of Social Security as well as the decline of traditional pension plans have put an increasingly hot spotlight on the need for retirement income from investments. As the population ages and lives longer, they will demand investment income and when yields on fixed-income instruments are at today's relatively paltry levels, they could turn to equity dividends instead.

Where do you see opportunities in dividend-paying stocks?

It is important to note that the opportunity in equity dividends is not simply a U.S. phenomenon. In fact, we believe that the case for the relative attractiveness of dividend payers vs. non-income-paying equities may be even greater in emerging markets.

Despite a great deal of progress in many markets over the last 20 years, corporate governance practices in emerging markets still can leave much to be desired. One always wants to “follow the money” to ensure that shareholders are getting a fair shake. There is no proof statement to that end like a healthy return of cash to shareholders via a dividend program. With payout ratios even lower in emerging markets than in the developed world, we see even more potential room for future growth.

In summary, here are a few key points to remember:

- > Yields on stocks are at historical highs compared to investment alternatives
- > We anticipate solid dividend growth based on healthy corporate balance sheets
- > Current demographics favor dividends, and
- > The opportunity is not limited to just the United States, but is strong for emerging markets as well

This is why we believe equity income securities are a key investment strategy for investors right now.

Thanks for listening. For more investment insight, we encourage you to visit our web site: columbiamanagement.com

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Past performance does not guarantee future results.

Reference to “...dividend payers have significantly outperformed their non-dividend-paying peers over time...” Source: Ned Davis Research, Inc., February 28, 2011.

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