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Mutual Fund Center

Dividend Funds Offer Decent Yields

By Stan Luxenberg

NEW YORK (TheStreet) - At a time when bond yields are skimpy, plenty of investors have been considering dividend-paying stocks as a source of income. But when stock prices rise, dividend yields fall. And after the recent rally, dividend checks have begun to seem meager. The current yield on the S&P 500 is 1.76%, down from 4.12% at the bottom of the market in March 2009.

For investments that still provide decent yields, consider dividend funds. A top choice is **iShares Dow Jones Select Dividend**(DVY), which yields 3.42%.

Holdings include cigarette maker **Lorillard**(LO), which yields 5.6%, and power producer **Entergy**(ETR), with a yield of 4.5%. Another compelling dividend fund is **Federated Equity Income**(LEIEX), which yields 2.82% and holds **AT&T**(T), with a 5.8% yield.

To own a broad collection of dividend payers, try **MainStay Epoch Global Equity Yield**(EPSYX), which yields 3.1%. Besides holding top U.S. dividend payers, MainStay also buys foreign companies. The global approach provides an advantage because many overseas companies yield more than their U.S. counterparts. The geographic diversification also helps to make the fund's income stream particularly reliable. If companies in one region suffer, holdings in other countries may continue to prosper.

Portfolio manager Eric Sappenfield is wary of sluggish companies that pay high dividends. Instead, he prefers steadily growing businesses that can increase their dividends every year. Of the approximately 100 stocks in the portfolio, 90 increased their dividends last year. The average dividend increase was 11%, a substantial hike that indicates the companies are confident about their prospects for future growth.

In 2008, 61 holdings increased payouts, a noteworthy achievement in a year when many blue chips slashed their dividends.

To avoid dividend cuts, Sappenfield looks for rock-solid companies that can increase earnings for years to come. He likes companies that have plenty of cash flow to cover dividends. Many holdings use part of their extra reserves to pay down debt or buy

back shares. "We like stocks with battleship balance sheets," he says.

Sappenfield's kind of steady stocks lagged during the rally of 2009, when investors raced to take on more risk. But the MainStay fund has distinguished itself in downturns, outdoing 90% of competitors in the turmoil of 2008, according to Morningstar. During the past five years the fund has returned 4.6% annually, outdoing 75% of competitors in the world stock category.

One of Sappenfield's favorite holdings is **BCE**(BCE), a dominant Canadian telecom provider, which yields 5.1%. While the number of customers is not growing much, the company is increasing the services that it provides. Revenues are growing because of increasing sales of broadband service over the mobile network.

Another holding is **Diageo**(DEO), the UK-based producer of leading liquor brands, including Johnnie Walker and Smirnoff. The stock yields 4.0%. Sales are relatively steady, since people buy alcoholic beverages in good years and bad. Sappenfield says that he especially likes the stock because the business doesn't require heavy capital expenditures. That means plenty of cash can be used to buy back stock or pay dividends.

Sappenfield is keen on **Anheuser-Busch Inbev**(BUD), a Belgian beer company with big sales in the U.S., Europe, and the emerging markets. The company acquired Anheuser-Busch in 2008, and the merger has proved to be a success, he says. The management has achieved synergies, cutting costs and increasing sales in the emerging markets.

To pay for the big acquisition, the company took on a huge amount of debt. Since then it has been using the rich cash flow to pay down debt. Sappenfield says that the stock only yields 0.70%, but as debt declines, the management will have enough cash to raise dividends. "If they get debt down by 2012, they will be able to pay for a meaningful raise in the dividend," he says.

Stan Luxenberg is a freelance writer specializing in mutual funds and investing. He was executive editor of Individual Investor magazine.