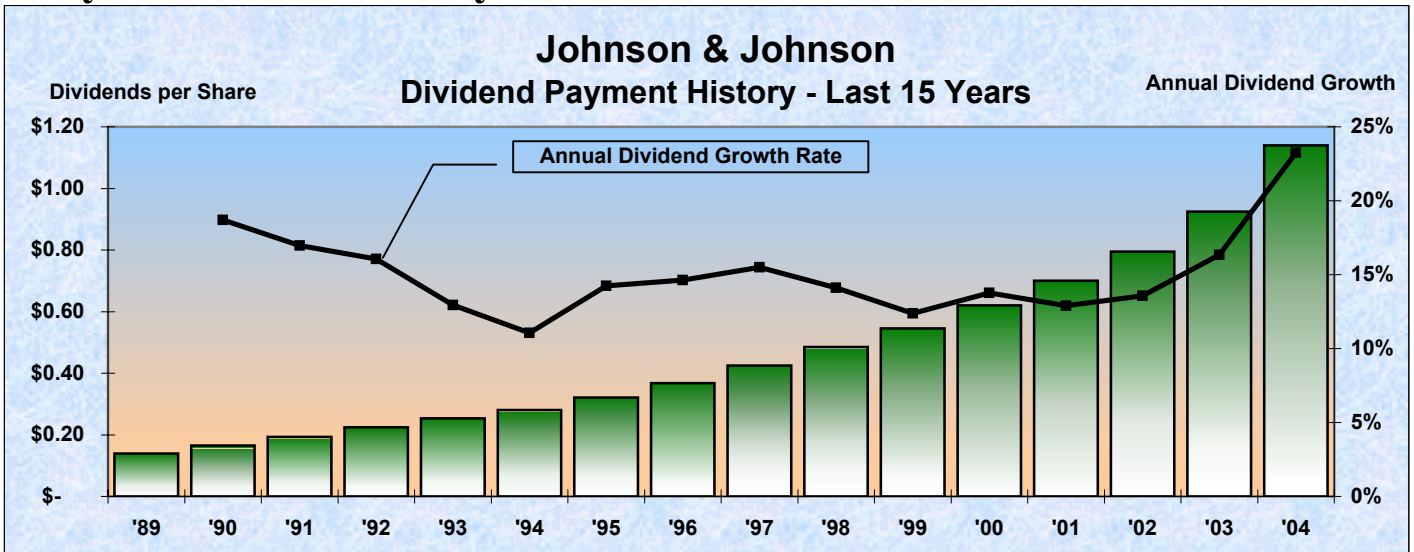


# May 2004 Commentary



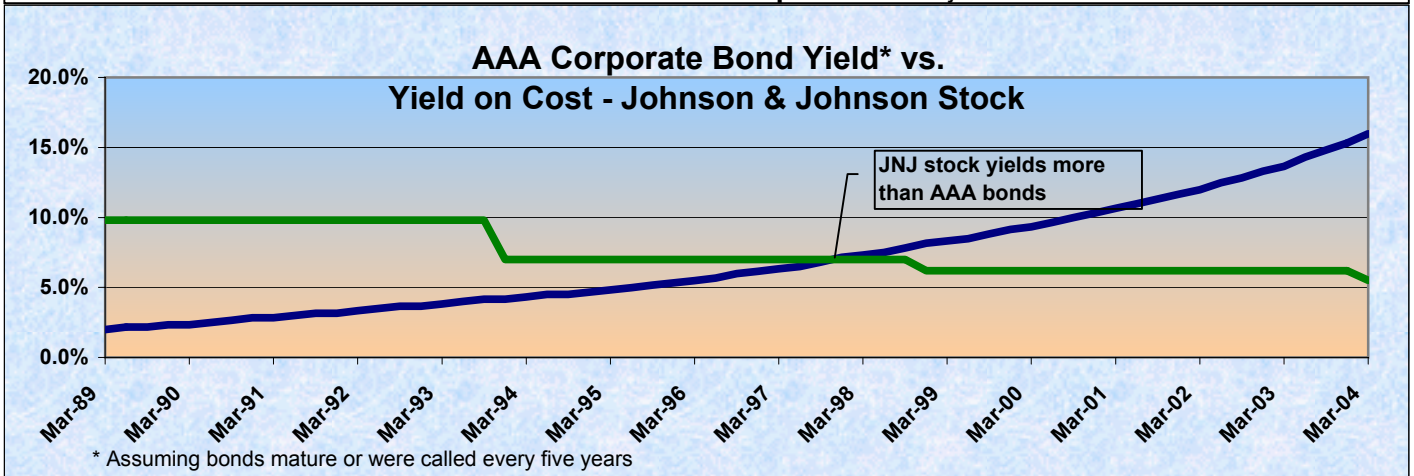
## Building an Income Stream with Stock Dividends

When building an income stream for retirement, investors traditionally purchase stocks for growth and bonds to provide current income. However, in today's low interest rate environment, it is very difficult for most retirees to obtain the income they desire from their bond investments. For investors 10 or 15 years away from retirement, or for those who don't yet need substantial income from their investments, a strategy of building an income stream with stock dividends might be very rewarding. The major benefit of creating an income stream with stock dividends as opposed to bond interest is that over time as dividend payments rise the income stream grows, potentially outpacing both inflation and bond earnings.

Here's an example of how it might work: For example, 15 years ago **Johnson & Johnson (JNJ)** was paying a split adjusted dividend of \$0.14 per share, offering a 2.6% dividend yield. The dividend yield was not particularly high considering a Triple A rated corporate bond might have yielded 10% at that time. But, over the next 15 years JNJ grew its dividend payment by 11% to 23% per year (averaging 14% over 15 years - see chart above) and in 2004 JNJ is projected to pay dividends of \$1.14 per share. The yield on the original cost is now over 15%!

The chart below compares the yield of JNJ based on the original cost vs. interest income from Triple A rated corporate bonds. Those bonds once provided a yield of 10%, but today only offer about a 5% yield. The yield on JNJ stock rose above the yield on the corporate bonds after 9 years and is now more than 3 times higher.

**"An increase in the cash dividend is a favorable development."** Benjamin Graham



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**"All progress is based upon a universal innate desire on the part of every organism to live beyond its income."** Samuel Butler, 1912

While the prices of stocks tend to be quite volatile, the volatility of dividends is significantly less. Generally, companies don't pay dividends if they are not sustainable. However, from time to time, some companies are forced to cut or even eliminate their dividend payments, but there are also many companies that consistently grow their dividend payments. These companies tend to be large and well established. The dividend record of six such companies are shown below.

Some of these stocks had high initial yields: **General Electric** offered a 3.8% yield in 1989. The company has grown its dividend by 12% per year over the last 15 years and now yields over 20% on its 1989 purchase price. On the other hand, some stocks had a low initial yield: **Home Depot** only offered a 0.7% yield, but the company expanded its dividend by 27% per year and would now yield 25% on its 1989 purchase price.

From a tax perspective, dividend income is favored over interest income for those in a tax bracket higher than 15%. Qualified dividends are now taxed at a rate of 15%, whereas interest income is taxable at regular income tax rates. This tax advantage is reconized by many corporations and many are making larger than normal dividend increases or even instituting a dividend for the first time. While investors can always question the quality of earnings, cash dividends aren't subject to accounting chicanery and are appreciated by investors looking to meet their income needs.

**"Annual income twenty pounds, annual expenditure nineteen six, result happiness. Annual income twenty pounds, annual expenditure twenty pound ought and six, result misery."** Charles Dickens

