



RUSS MACKAY  
MCLEAN & PARTNERS

## The Benefits of Dividends

### *Taxes, Inflation and Portfolio Performance*

BY RUSS MACKAY

*Three major concerns to investors are taxes, inflation and portfolio performance. Let's review some practical advice to help you address each of these concerns.*

2010 Tax Rates <i>(highest marginal tax bracket)</i>			
	Interest	Capital Gains	Eligible Canadian Dividends
AB	39.00%	19.50%	15.88%
BC	43.70%	21.85%	21.45%
ON	46.41%	23.20%	26.57%

Source: taxtips.ca

When it comes to taxes, you as an investor can put yourself in the driver's seat and take advantage of the significant differences in tax rates, depending on the source of your taxed investment. As you can see from the table, Alberta's in the highest-marginal tax bracket can reduce their tax bill by more than 59 percent by shifting their source of income from interest bearing investments to dividend producing investments.

An Alberta investor in the maximum tax bracket takes home \$61,000 after tax on \$100,000 of interest income. If this same investor were to shift his/her investment strategy to dividend income, he/she would take home \$84,120 on the same \$100,000 of income, over 37 percent more money in their pocket! And, given the current interest rate environment, it might not be difficult to match or exceed these rates with dividend yields.

Inflation is the second threat to an investor's wealth. To maintain your purchasing power in the future you must ensure that your income is rising at least as fast as inflation. To put this into perspective, if you require \$200,000 of income annually to maintain your lifestyle, and inflation runs at 2 percent over the next decade, you'll need an income stream of \$243,798 in ten years time to maintain your purchasing power. At a 6 percent inflation rate that jumps to \$358,170!

	<u>Dividend</u> <u>Yield</u>	<u>5-Year</u> <u>Annual</u> <u>Div. Growth</u>
<b>Canada</b>		
Bank of Nova Scotia	4.22%	11%
Shawcor Ltd	1.82%	46%
Brookfield Asset Mgmt	2.61%	14%
<b>U.S.</b>		
IBM	1.63%	25%
PepsiCo Inc.	2.89%	16%
Waste Management Inc.	3.49%	9%
<b>International</b>		
Canon	2.85%	20%
Sage Group	3.10%	34%
State Bank of India	1.34%	23%

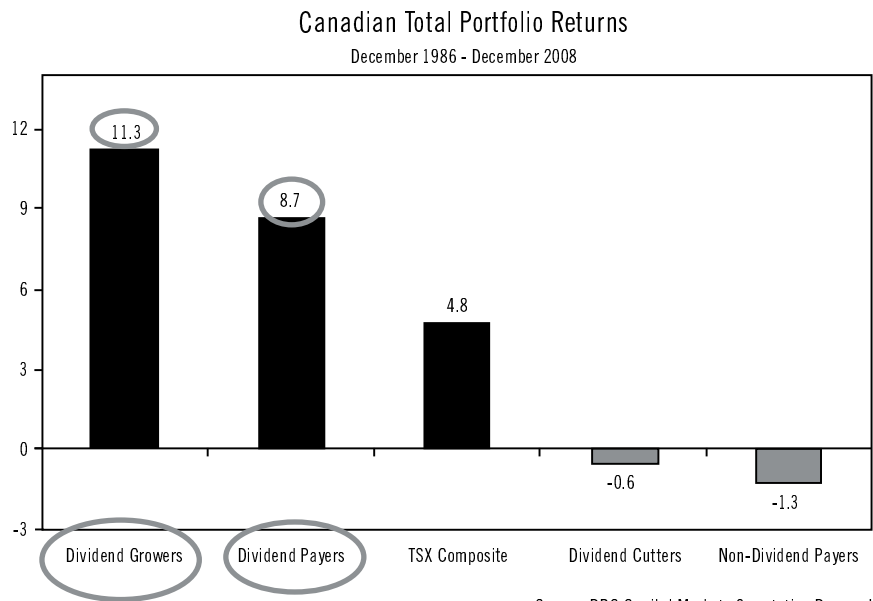
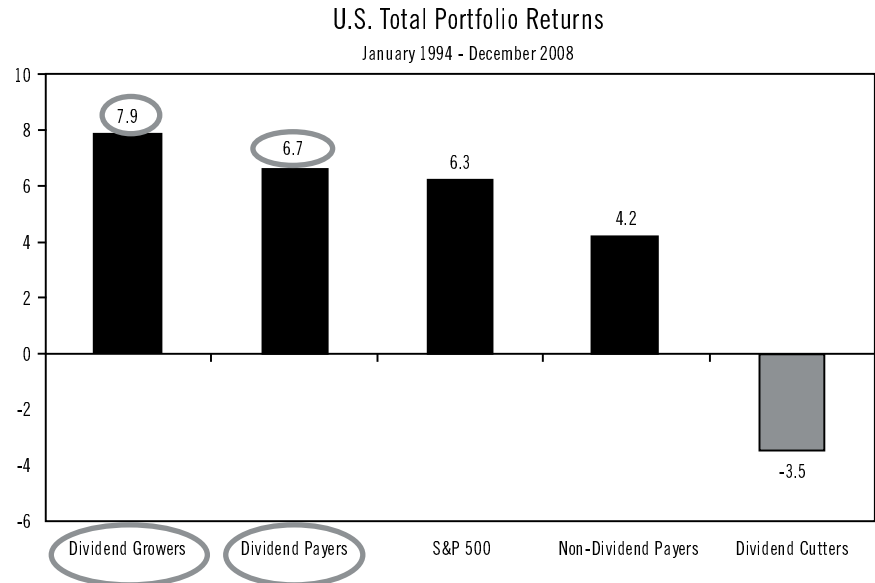
Source: Bloomberg, January 18, 2010

When looking at dividend paying investments, the key for inflation protection is to own those investments which will increase their dividends by at least the inflation rate. There are great opportunities in the stock market for what we refer to as “dividend growth stocks”. These are stocks which consistently pay and increase their dividends over time. We have identified some examples of such companies in Canada, the U.S, Europe and Asia (see table). Imagine having the income from your portfolio increase by these amounts!

There are also dividend opportunities in the preferred share market in what we refer to as “floating rate preferreds”. These are preferred shares which pay a dividend and adjust with the changes in interest rates. So if your view is that inflation and interest rates will rise over time, floating rate preferred shares should be considered.

Finally, portfolio performance is a key concern to all investors. We have always said that in the long term there are really only two things that matter when it comes to investing in the market; earnings and interest rates. A company's earnings set the foundation for what the shares will be worth in the future. And if a company has a growing stream of earnings, they are in a much better position to pay and grow a dividend to their shareholders in the future.

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Source: RBC Capital Markets Quantitative Research

In the above charts you can see that the annualized returns for Dividend Growers and Dividend Payers have outperformed the market.

If you are concerned about taxes, inflation and performance, then consider incorporating dividend paying investments into your overall portfolio strategy.



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Tel. (403) 234-6118 Email: [bmoore@mcleanpartners.com](mailto:bmoore@mcleanpartners.com)

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