

The 8 Rules Of Dividend Investing

Updated January 20th, 2021 by Ben Reynolds

The 8 Rules of Dividend Investing help investors determine what dividend stocks to buy and sell for rising portfolio income over time.

This can help you find the right securities to build or grow your retirement portfolio.

All of The 8 Rules are supported by academic research and ‘common sense’ principles from some of the world’s greatest investors.

Each of The 8 Rules of Dividend Investing are listed below:

- [Rule #1: The Quality Rule](#)
- [Rule #2: The Bargain Rule](#)
- [Rule #3: The Safety Rule](#)
- [Rule #4: The Growth Rule](#)
- [Rule #5: The Peace of Mind Rule](#)
- [Rule #6: The Overpriced Rule](#)
- [Rule #7: The Survival of the Fittest Rule](#)
- [Rule #8: The Hedge Your Bets Rule](#)

Dividend Investing Rules 1 to 5: What to Buy

Rule # 1 – The Quality Rule

“The single greatest edge an investor can have is a long term orientation”

– Seth Klarman

Common Sense Idea: Invest in high quality businesses that have a proven long-term record of stability, growth, and profitability. There is no reason to own a mediocre business when you can own a high quality business.

How We Implement: Dividend history (the longer the better) is a key component of our [Dividend Risk scores](#). Only stocks with A and B ranked Dividend Risk scores are eligible to be in the Top 10 of [The Sure Dividend Newsletter](#).

Evidence: [The Dividend Aristocrats](#) (S&P 500 stocks with 25+ years of rising dividends) have generated a Sharpe Ratio of 1.08 over the last 10 years (through December 2020) versus a Sharpe Ratio of 1.03 for the S&P 500.

Source: [S&P 500 Dividend Aristocrats Factsheet](#)

	ANNUALIZED RISK			ANNUALIZED RISK-ADJUSTED RETURNS		
	3 YRS	5 YRS	10 YRS	3 YRS	5 YRS	10 YRS
Total Return	17.85%	14.64%	12.63%	0.59	0.89	1.08
Price Return	17.82%	14.61%	12.62%	0.44	0.69	0.86
Net Total Return	17.84%	14.63%	12.63%	0.55	0.83	1.01
BENCHMARK* Total Return	18.79%	15.26%	13.54%	0.75	1	1.03
BENCHMARK* Price Return	18.79%	15.24%	13.54%	0.64	0.85	0.85
BENCHMARK* Net Total Return	18.79%	15.25%	13.54%	0.72	0.95	0.97

Risk is defined as standard deviation calculated based on total returns using monthly values.

* The index benchmark is the S&P 500

Rule # 2 – The Bargain Rule

“Price is what you pay, value is what you get”

– Warren Buffett

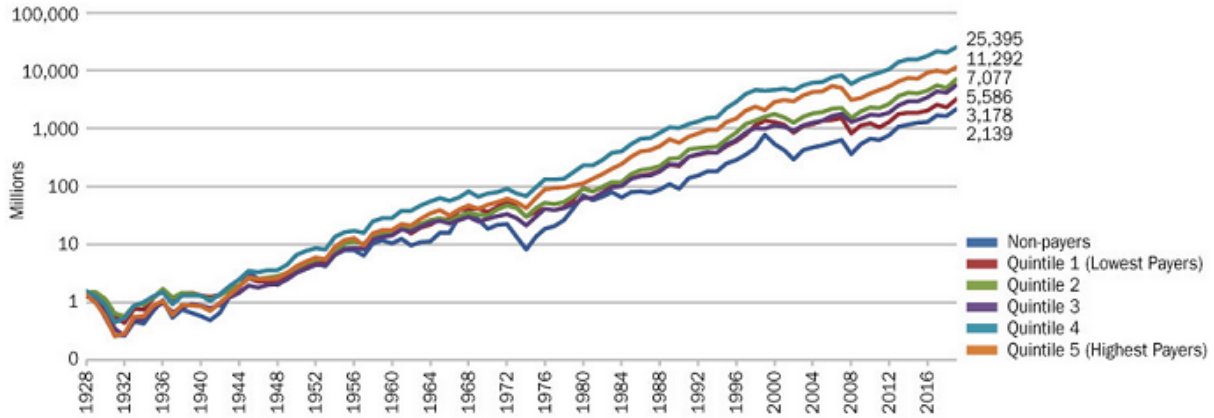
Common Sense Idea: Invest in businesses that pay you the most dividends per dollar you invest. All things being equal, the higher the dividend yield, the better. Additionally, only invest in stocks trading below their historical average valuation multiple to avoid investing in overpriced securities.

How We Implement: In *The Sure Dividend Newsletter*, we only invest in stocks with dividend yields equal to or greater than the S&P 500’s dividend yield. We also rank stocks by expected total returns to create our Top 10 list in *The Sure Dividend Newsletter*. Dividend yield is one of three components of [expected total returns](#), along with growth returns and valuation multiple changes.

Evidence: The highest yielding quintile of stocks outperformed the lowest yielding quintile of stocks by 1.72% per year from 1928 through 2019.

Source: [Dividends: A Review of Historical Returns by Heartland Funds](#)

Hypothetical Growth of 1 Million From January 1928 to December 2019



	Non-Payers	Quintile 1	Quintile 2	Quintile 3	Quintile 4	Quintile 5
Average Annual Total Return (%)	8.69	9.16	10.11	9.83	11.65	10.68
Annualized Standard Deviation (%)	32.86	22.63	19.28	20.55	20.85	23.67
Sharpe Ratio	0.16	0.26	0.35	0.31	0.40	0.31

Source: Kenneth R. French© and CRSP, 1/1/1928 to 12/31/2019

Past performance does not guarantee future results. The hypothetical example is for illustrative purposes only and does not represent the returns of any particular investment. All indices mentioned are unmanaged. It is not possible to invest directly in an index.

Rule # 3 – The Safety Rule

“The secret of sound investment in 3 words; margin of safety”

– Benjamin Graham

Common Sense Idea: If a business is paying out all its income as dividends, it has no margin of safety. When a business downturn occurs, the dividend must be reduced. It therefore makes sense to invest in businesses that are not paying out nearly all of their earnings as dividends.

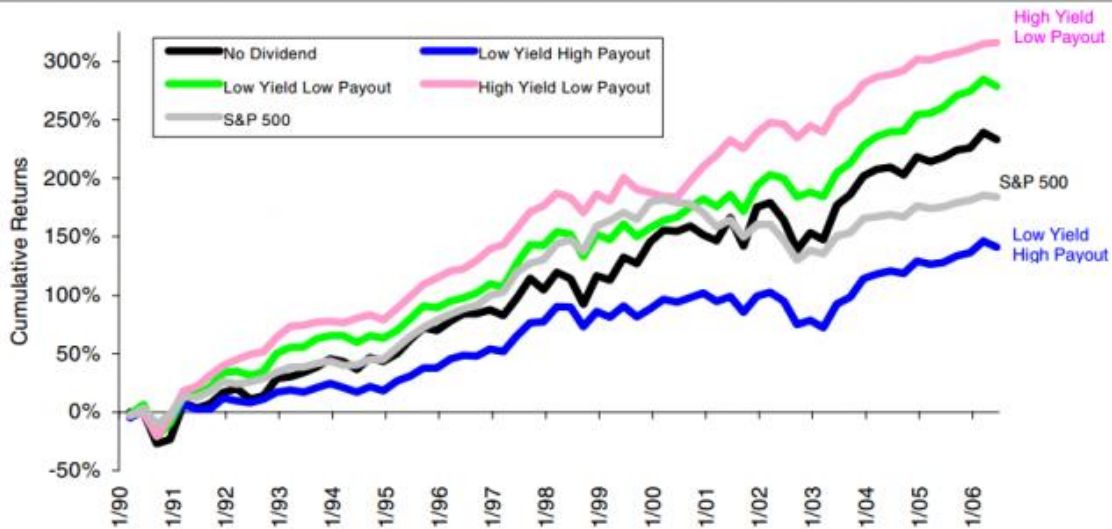
How We Implement: The payout ratio (the lower the better) is a key component of our [Dividend Risk scores](#). Only stocks with A and B ranked Dividend Risk scores are eligible to be in the Top 10 of [The Sure Dividend Newsletter](#).

Evidence: High yield low payout ratio stocks outperformed high yield high payout ratio stocks by 8.2% per year from 1990 to 2006.

Source: [High Yield, Low Payout by Barefoot, Patel, & Yao](#)

Dividend Yield and Payout Ratio

Equal-weighted performance from January 1990 to June 2006, quarterly rebalance



Source: Credit Suisse Quantitative Equity Research.

Rule # 4 – The Growth Rule

“All you need for a lifetime of successful investing is a few big winners”

– Peter Lynch

Common Sense Idea: Invest in businesses that have a history of solid growth. If a business has maintained a high growth rate for several years, they are likely to continue to do so. The more a business grows, the more profitable your investment will become. Dividends cannot grow over the long run without rising earnings.

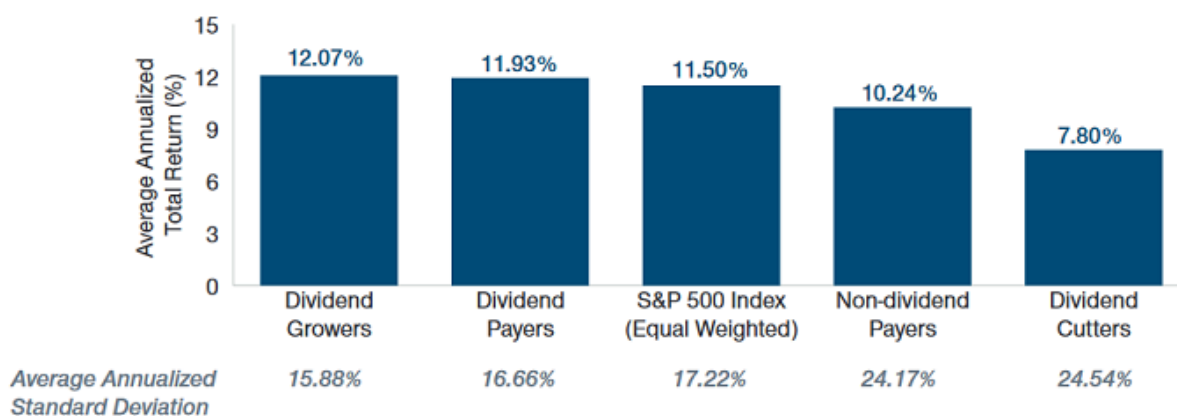
How We Implement: We rank stocks by expected total return (the higher the better) to create our Top 10 list in [The Sure Dividend Newsletter](#). Growth rate is one of three components of [expected total returns](#), along with dividend yield and valuation multiple changes. We create five year forward expected growth rates for all the 600+ securities in [Sure Analysis](#), which powers our recommendations in *The Sure Dividend Newsletter*.

Evidence: Dividend growers have outperformed non-dividend paying stocks by 1.8% annually from March 31st 1972 through March 31st 2020.

Source: [The Appeal of a Dividend Strategy Amid Chaotic Markets](#)

Dividend Growers Have Outperformed

(Fig. 1) S&P 500 Index: returns and volatility



March 31, 1972, to March 31, 2020.

Past performance is not a reliable indicator of future performance. For illustrative purposes only. It is not possible to invest directly in an index.

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Rule # 5 – The Peace of Mind Rule

“Psychology is probably the most important factor in the market – and one that is least understood”

– David Dreman

Common Sense Idea: Look for businesses that people invest in during recessions and times of panic. These businesses will be more likely to continue paying rising dividends during a recession. We would also expect these securities to, in general, have lower stock price standard deviations.

How We Implement: We assign a qualitative recession score to every security in [The Sure Analysis Research Database](#). This recession score factors in to our Dividend Risk scores. Only stocks with A and B ranked Dividend Risk scores are eligible to be in the Top 10 of [The Sure Dividend Newsletter](#).

Evidence: The S&P Low Volatility index have generated a Sharpe Ratio of 1.13 over the last 10 years (through December 2020) versus a Sharpe Ratio of 1.03 for the S&P 500.

Source: [S&P 500 Low Volatility Index](#)

Risk

	ANNUALIZED RISK			ANNUALIZED RISK-ADJUSTED RETURNS		
	3 YRS	5 YRS	10 YRS	3 YRS	5 YRS	10 YRS
Total Return	14.81%	12.41%	10.82%	0.56	0.85	1.13
Price Return	14.87%	12.42%	10.84%	0.39	0.63	0.85
Net Total Return	14.83%	12.41%	10.83%	0.51	0.78	1.04
BENCHMARK* Total Return	18.79%	15.26%	13.54%	0.75	1	1.03
BENCHMARK* Price Return	18.79%	15.24%	13.54%	0.64	0.85	0.85
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Risk is defined as standard deviation calculated based on total returns using monthly values.

* The index benchmark is the S&P 500

Dividend Investing Rules 6 & 7: When to Sell

Rule # 6 – The Overpriced Rule

“Pigs get fat, hogs get slaughtered”

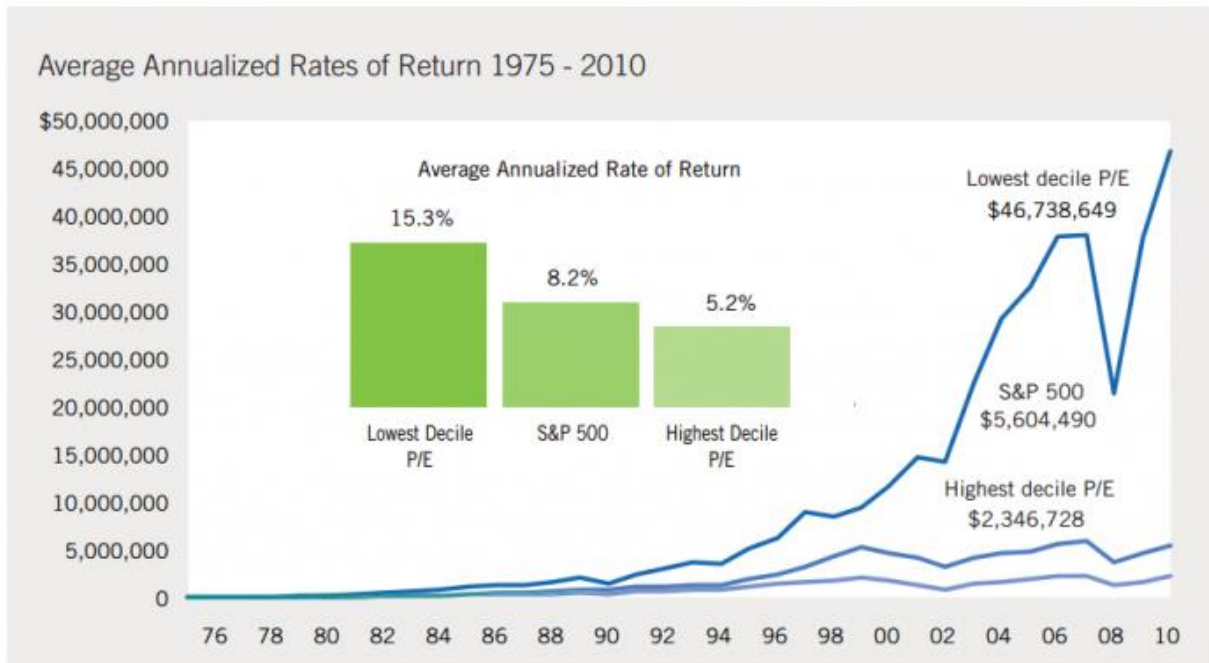
– Unknown

Common Sense Idea: If you are offered \$500,000 for a \$250,000 house, you take the money. It is the same with a stock. If you can sell a stock for much more than it is worth, you should. Take the money and *reinvest* it into businesses that pay higher dividends.

How We Implement: We review past recommendations for sells in [The Sure Dividend Newsletter](#) when their expected total returns are lower than the greater of the 20 Year T-Bond or our expected total return estimate for the S&P 500. Low expected total return securities are typically overvalued and tend to have higher P/E ratios.

Evidence: The lowest decile of P/E stocks outperformed the highest decile by 9.02% per year from 1975 to 2010.

Source: [The Case for Value](#) by Brandes Investment Partners



Source: Compustat via Faceset. Deciles are rebalanced annually. Data as at 12/31/10.

Rule # 7 – The Survival of the Fittest Rule

“When the facts change, I change my mind. What do you do, sir?”

– John Maynard Keynes

Common Sense Idea: If a stock you own reduces its dividend, it is paying you less over time instead of more. This is the opposite of what should happen. You must admit the business has lost its competitive advantage and reinvest the proceeds of the sale into a more stable business.

Financial Rule: We issue sell or pending sell for past recommendations in [The Sure Dividend Newsletter](#) when their dividend is reduced or eliminated. We also analyze past recommendations with an “F” Dividend Risk score for a potential sell.

Evidence: Stocks that reduced or eliminated their dividends had a 0% return from 1972 through 2013.

Source: [Dividend Viewpoint by Proshares](#)

Dividend Cutters Are Punished

	Cutters	Raisers
Total S&P 500	60	159
% Breakdown	14%	38%
Performance YTD	-11.95	10.04

Source: Bloomberg, ProShares. Based on dividend per share announcements from 1/1/20–11/30/20 broken down as a percentage of dividend payers in each index. Past performance is no guarantee of future results.

Dividend Investing Rule 8: Portfolio Management

Rule # 8 – The Hedge Your Bets Rule

“The only investors who shouldn’t diversify are those who are right 100% of the time”

– John Templeton

Common Sense Idea: No one is right all the time. Spreading your investments over multiple stocks reduces the impact of being wrong on any one stock.

Financial Rule: Build a diversified portfolio over time. Use The 8 Rules of Dividend Investing as applied in [The Sure Dividend Newsletter](#) to rank high quality dividend growth stocks. Buy the highest ranked stock of which you own the least each month to build your diversified portfolio over time.

Evidence: 90% of the benefits of diversification come from owning just 12 to 18 stocks.

Source: Frank Reilly and Keith Brown, Investment Analysis and Portfolio Management, page 213