

## Dividends: Increasing Ability to Pay

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As we progress through 2004, the ability of corporations to pay and increase dividends continues to improve. As the following table shows, an improved ability to pay has been quite evident in the higher level of earnings per share.

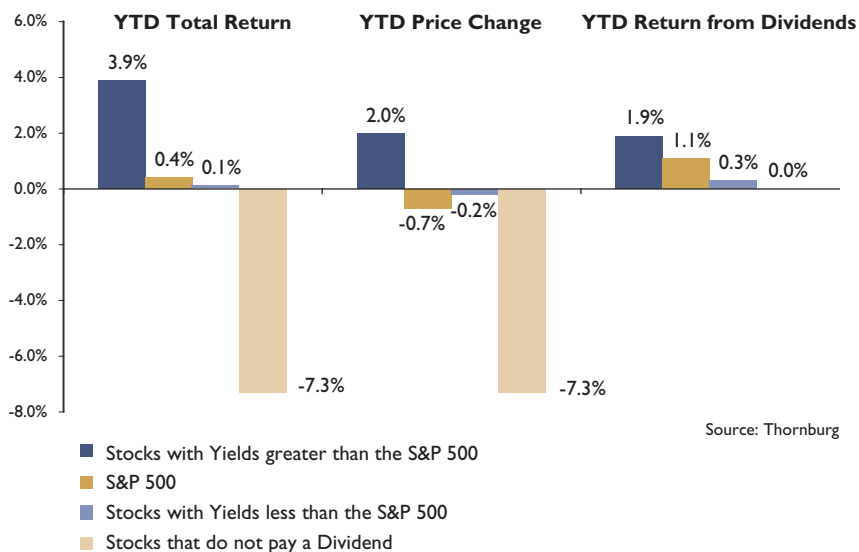
	December 2003	August 2004	% Change
S&P 500 Annualized EPS	\$52.73	\$62.18	17.9%
S&P 500 Annualized Dividend	\$17.38	\$18.60	7.0%
S&P 500 Payout Ratio	33%	30%	

Through the end of August, the companies in the S&P 500 were expected to pay an annualized dividend of \$18.60 per unit of S&P 500. This represents an increase of 7% compared to a dividend of \$17.38 per unit at the end of December 2003. This growth in dividends paid has been meaningfully higher than the prevailing inflation rate of about 2.7%, providing improved purchasing power for the recipients of those dividends.

Earnings have grown substantially faster than dividends over the same time period. Through the end of August, the companies in the S&P 500 were expected to generate annualized earnings per share of \$62.18. This represents an increase of 17.9% compared to \$52.73 at the end of December 2003. As earnings have soared, the payout ratio for the S&P 500 has fallen from 33% to an all-time low of 30%. Thus, despite a substantial increase in dividends paid, the corporate ability to pay dividends has continued to improve throughout 2004. Actually, the ability to pay and increase dividends has never been better, giving us comfort in our expectations that growth in dividends should continue at a very nice pace in future years.

Not only have companies that have increased their dividends provided improved purchasing power for shareholders in 2004, but as the following table shows, dividend paying stocks have also provided outsized returns.

December 31, 2003 through August 31, 2004



As the rate of growth in earnings appears to have peaked in the U.S., investors have been less willing to pay higher prices for a more uncertain outlook on economic expansion. Additionally, market multiples have contracted as investors have widely anticipated the impact of rising interest rates, which will not only put the brakes on economic expansion, but will also make future earnings less valuable. Thus companies that would supposedly have higher expected future growth over the long-term (i.e. lower dividend paying stocks, or no dividend paying stocks) have been the worst performing investments year-to-date, despite possibly having superior near-term growth rates. In turn, companies that have provided above average dividend yields have also provided better share price returns, as well as superior total returns to shareholders.

*Note: All reference to dividends ignores the special one-time \$3.00 dividend to be paid by Microsoft in November 2004.*

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The S&P 500 Index is an unmanaged index of common stocks that's generally considered representative of the U.S. Market.

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