Dividend Power

Sometimes overlooked but never overrated

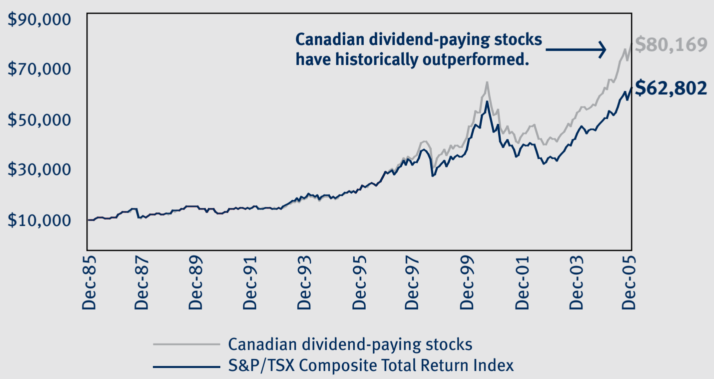
Dividend-paying stocks have always made a significant contribution to the overall returns of the stock market. Investors have been reminded of this in recent years by the strong performance of companies that pay regular dividends. And while the popularity of dividends has varied over time, it shouldn't have. It's important to recognize how powerful dividends can be and how easy it is to include dividend-paying stocks in a portfolio.

DON'T UNDERESTIMATE THE POWER OF DIVIDENDS

- Investors have sometimes overlooked the contribution of dividends to long-term performance. During periods of normal market returns between 8% and 10%, a dividend yield of 2% to 3% represents a significant portion of this total (total returns = capital growth + dividends).
- The old adage "a bird in hand is better than two in the bush" certainly applies to dividends. During the late 1990s many investors shifted away from stable, mature companies that paid dividends in favour of more speculative-growth businesses. The market pullback between 2000 and 2002 reminded investors that dividend-paying stocks can provide continual returns in both good and bad markets.

Chart 1: Canadian dividend-paying stocks pay off for investors

Growth of a $10,000 investment



Source: RBC Asset Management, RBC Capital Markets

THE POWER GROWS WHEN THE DIVIDEND GROWS

- A company's dividend policy can be indicative of how well (or how poorly) a firm is managing its cash flow.
- Companies that manage their cash flow effectively tend to sustain their dividend payouts and often grow them over time. Research at RBC® has shown that these companies also tend to grow their earnings, which usually leads to higher share prices.
- As shown in Table 1, the real power is in finding companies that consistently grow their dividends over time.

Table 1: Companies that increased their dividends have paid off even more

	1 year	5 year	10 year
S&P/TSX Composite Index	22.7%	9.2%	8.6%
Stocks that pay dividends	22.8%	16.1%	15.5%
Stocks that do not increase their dividends	22.4%	2.4%	1.3%
Stocks that increase their dividends	**22.7%**	**18.9%**	**17.2%**

The chart on the first page showed that dividend-paying stocks have outperformed the Index. You get an even bigger benefit with stocks that increase their dividends.

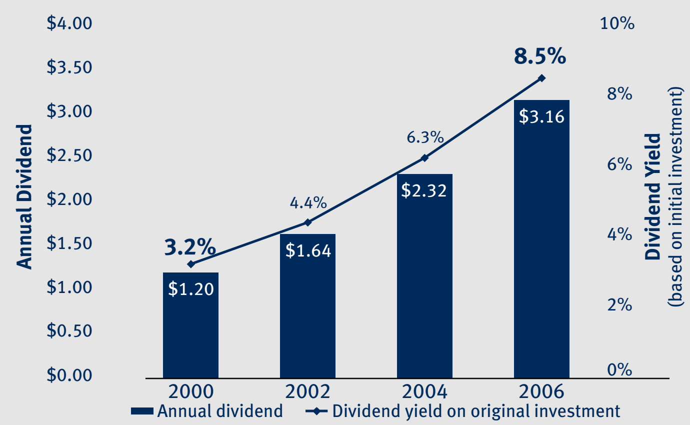
Source: RBC Capital Markets Quantitative Research. May 30, 2006 (annual compound returns)

DIVIDEND POWER IN ACTION

- The companies held in the RBC Canadian Dividend Guaranteed Investment Fund (GIF) provide good examples of how dividends contribute to portfolio returns. The example shown in Chart 2 is based on the actual results of one of the underlying Fund's holdings.
- On December 31, 2000, this company paid an annual dividend of $1.20 per share, resulting in a dividend yield of 3.2% (dividend yield = actual dividend ÷ share price).
- Since that time, the company increased its dividend consistently, rising from $1.20 per year to $3.16 per year. For an investor who bought shares on December 31, 2000, the current dividend represents an 8.5% dividend yield on the original investment.
- This example illustrates why dividend-paying stocks can play such an important role in long-term investment success. What's even more compelling is that this example only reflects the importance of dividend growth — it does not account for any increase in the company's share price.

Chart 2: The positive effect of growing dividends

The yield grows as the dividend grows



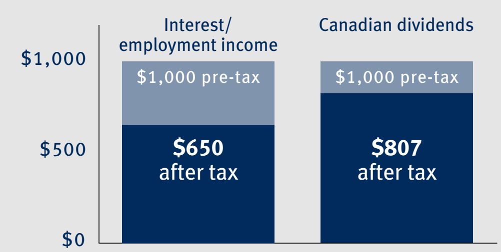
This chart illustrates how the dividend yield increased from 3.2% to 8.5%. (Values are based on the original purchase price on December 31, 2000.)

NEW CANADIAN TAX LEGISLATION MAKES DIVIDENDS EVEN MORE POWERFUL

- For a long time, Canadian investors have benefited from the tax-efficient nature of dividend income in non-registered accounts. This is because dividends paid by Canadian corporations receive favourable tax treatment compared to interest income, which is fully taxed like employment income. (Note: within registered plans such as an RRSP, all forms of income are sheltered from tax until withdrawn.)
- The tax benefit of dividends was made even better in the 2006 Federal Budget when new tax legislation was introduced to further reduce the amount of tax payable on dividends.

Canadian dividends receive preferential tax treatment

Based on $1,000 of investment income



Source: Ernst & Young Personal Tax Calculator; based on provincial/territorial tax rates, July 30, 2006. Assumes a 35% tax rate.

GETTING A BROADER RANGE OF DIVIDEND POWER

- More and more firms are seeing the importance of dividends to their investors. For example, companies such as Microsoft and Intel have started paying regular dividends in recent years, which was uncommon for that type of business in the 1990s. Investors benefit from a broader range of companies offering dividends as it provides diversification opportunities across more companies and more sectors.
- There are a large number of Canadian businesses that pay dividends to their shareholders — close to 120 companies in the S&P/TSX Composite Index are considered dividend-paying stocks. There are even more dividend-paying stocks in the U.S., with almost 400 of the companies in the S&P 500 Index paying regular dividends.
- More than 60% of all dividend-paying stocks in Canada are in the financial and resource sectors. In contrast, dividend-paying companies are spread across a much wider range of sectors in the U.S.
- Even though dividends paid by U.S. companies do not get the same preferential tax treatment as Canadian dividends, there are a broader range of growth opportunities in the U.S. market.

Number of dividend-paying stocks

Sector	S&P/TSX Composite Index	S&P 500 Index
Energy	20	24
Financials	25	84
Materials	27	29
Consumer Discretionary	14	71
Industrials	9	50
Consumer Staples	11	37
Utilities	5	27
Telecommunication Services	5	7
Health Care	3	31
Information Technology	1	23
Grand total	**120**	**383**

Source: RBC Asset Management, May 31, 2006

HOW TO GET THE POWER OF DIVIDENDS WORKING IN YOUR CLIENTS' PORTFOLIOS

- If you want to add the growth potential of equities to your clients' portfolios using a conservative approach, talk to them about the **RBC Canadian Dividend GIF**. It invests in blue-chip Canadian companies that offer above-average dividend yields and the potential to grow their dividends over time.
- If your clients already hold the **RBC Canadian Dividend GIF** or are not well diversified outside of Canada, talk to them about the **RBC O'Shaughnessy U.S. Value GIF**. Dividend-paying stocks from the U.S. market offer investors broader sector diversification than what is available by only investing in Canada.

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