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Gimme Shelter–and Income

By MIKE HOGAN

Exchange-traded funds focused on dividends offer diversification and income in a low-interest-rate world—and the promise of higher share prices, too.

WITH THE STOCK-VOLATILITY ROLLER COASTER picking up speed, wouldn't it be nice to have something to cushion the ups and downs?

Dozens of dividend-oriented exchange-traded funds, like the longstanding **iShares Dow Jones Select Dividend Index** (ticker: DVY) and State Street's **SPDR S&P Dividend** (SDY), offer an element that is hard to find these days—a healthy income stream. DVY has been yielding an unusually high 3.94% recently, while SDY has been offering 3.51%. Yields for other dividend ETFs have ranged between **Vanguard Dividend Appreciation**'s (VIG) 2.15% and **First Trust Morningstar Dividend Leaders**' (FDL) 4.73%.

Not that dividend payers are immune to a share-price free-fall, but a 2%-to-4% income cushion can make for softer landings and higher long-term returns. According to Ned Davis Research (**www.ndr.com**), S&P 500 companies that consistently raised dividends provided an average annualized return of 9.3% from 1972 through May 2010, versus 7.1% for dividend payers that didn't consistently hike payouts and 1.4% for non-dividend-paying stocks. And Ed Clissold, a senior global analyst for the firm, says dividend payers also exhibit less share-price volatility during periods of market stress.

However, shares of companies that don't pay dividends outpaced those of dividend payers in 2009 and for much of this year. That is very normal during the early stages of market recoveries, says Clissold. The largest and "safest" dividend payers usually don't crash as hard as smaller, riskier companies. They also don't usually become the bargains that bounce earliest in a bull rally. But now, says Clissold, "We're at that point in the cycle where dividend payers tend to outperform nonpayers."

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Tom Bloom for Barron's

With American companies sitting on a record $837 billion in cash, dividend payouts have started up again in earnest, reports Howard Silverblatt, Standard & Poor's senior index analyst–particularly among consumer staples issues. More than half of the S&P Dividend Aristocrats– companies that have increased dividends for 25 years running—have raised their payouts this year.

The only ETF specifically focused on this group is State Street's SDY. Its benchmark, the S&P High Yield Dividend Aristocrats Index, holds the 50 highest-yielding aristocrats of the S&P 1500. Currently in the high 40s, down from its 52-week high of $51.51, SDY is one of the largest, most liquid dividend ETFs, with assets of $2 billion and an average 429,000 shares traded daily.

SDY's prime competitor is the **BlackRock iShares Dow Jones Select Dividend Index** (DVY), which has $3.7 billion in assets and an average daily trading volume of 510,000 shares. It puts more emphasis on yields than SDY does. Broadly diversified across 10 market sectors, it's currently 28% weighted in utilities and 20% in consumer goods. SDY is similarly configured, but tilts toward consumer stocks more than utilities. Only about 10% of the holdings of either are financial companies. Before the 2008 meltdown, these outfits often accounted for half or more of many dividend ETFs. But since the crisis, many of these companies have slashed or eliminated their payouts.

ETF portfolio weightings can be found on sponsor Websites—although, not all critical metrics like turnover ratio. Those can be found on tracking sites like SeekingAlpha (**http://seekingalpha.com/article/30120-a-guide-to-dividend-etfs**), Marco Polo XTF (**www.xtf.com**) and ETF Database (**http://etfdb.com**).

If you want to avoid financials, **WisdomTree Dividend ex-Financials** (DTN) tracks an index of high-yielding U.S. stocks outside that group. Three sectors—industrial materials, utilities and consumer goods—each account for 17% of DTN's holdings. Vanguard Dividend Appreciation is far larger, more liquid and more diversified, but is about 7% invested in financials.

All-Season Investments

Regardless of what investment sectors you favor, dividend ETFs can complement your portfolio and offer a solid income stream.

Fund / Ticker	Recent Price	YTD Return	Yield
SPDR S&P Div / SDY	$47.53	4.47%	3.51%
iShares Dow Jones Select / DVY	44.86	4.11	3.94
Vanguard Dividend Appreciation / VIG	46.43	0.09	2.15
Vanguard High Div Yield / VYM	37.27	-0.61	3.07
PowerShares HighYield / PEY	8.08	7.78	4.38
First Trust Morningstar / FDL	14.01	0.28	4.73
WisdomTree Div ex-Fin / DTN	41.45	2.88	4.22
PowerShares Intl Div / PID	13.77	-0.70	3.01
iShares Dow Jones EPAC Select / IDV	28.79	-6.01	4.94

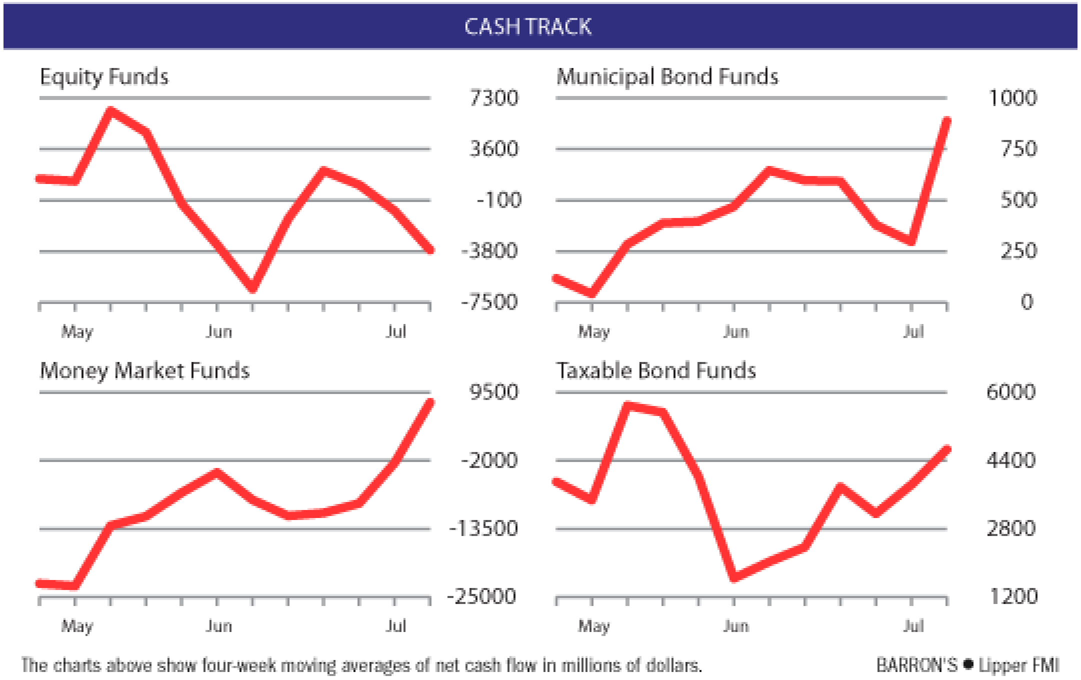
Sources: Company reports; Morningstar; Bloomberg

Many fund managers agreewith Binky Chadha, Deutsche Bank's chief strategist, that banks are due to resume or raise payouts. About 31% of **PowerShares High Yield Equity Dividend Achievers** (PEY) holdings are financials, as are about 11% of **Vanguard High Dividend Yield** (VYM). While both PEY and VIG aim to hold 50 companies with 10 straight years of dividend increases, VYM tracks a global benchmark more focused on yields.

Want overseas exposure? **PowerShares International Dividend Achievers** (PID) tracks an index composed of mostly United Kingdom, Canadian and Mexican companies that have boosted their dividends for five years running. About 27% are foreign banks. A smaller, less liquid ETF, **Dow Jones International Select Dividend Index** (IDV), invests in about 100 equities from a dozen developed countries, about 20% of which are financials. Almost a quarter of its holdings are in Australia, a strategic gateway to high-growth Asian nations.

First Trust Morningstar Dividend Leaders Index (FDL) gets still broader international exposure by investing in U.S. multinationals with significant overseas sales.

And regardless of what sectors you favor, Motley Fool (**www.fool.com**) analyst Todd Wenning advises picking ETFs that fill portfolio gaps. His strategy: Take advantage of market dips to diversify your portfolio with dividend payers, then reinvest the income "while you wait for share prices to recover."



Sick of Stocks? Equity funds had average net weekly outflows of $3.7 billion in the four weeks ended Wednesday, said Lipper FMI. Money funds' weekly inflows averaged $7.8 billion; muni funds', $889 million. A net $4.7 billion left taxable-bond funds weekly.

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