

■ FINANCIAL ■
insight

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INSIDE

Dividends are important
Are you affected by new
tax reporting rules?

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Dividends are important



Dividends are important

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Dividends have always been an important consideration when investing. Historically over 50% of the returns generated by U.S. stocks have come from dividends. If we consider the past decade, dividends have provided an even larger proportion of return. Dividends can also provide stability in returns. For example, dividend-paying companies tend to exhibit lower price volatility and relative downside protection when markets are tumultuous.

DIVIDEND CONTRIBUTION TO TOTAL RETURN

	Price Pct. Change	Dividend Contribution	Total Return	Dividends Pct of TR	Avg. Payout Ratio
1930s	-41.9%	56.0%	14.1%	NA	90.1%
1940s	34.8%	100.3%	135.0%	74.3%	59.4%
1950s	256.7%	180.0%	436.7%	41.2%	54.6%
1960s	53.7%	54.2%	107.9%	50.2%	56.0%
1970s	17.2%	59.1%	76.4%	77.4%	45.5%
1980s	227.4%	143.1%	370.5%	38.6%	48.6%
1990s	315.7%	117.1%	432.4%	27.0%	47.6%
2000s	-24.1%	15.0%	-9.1%	NA	35.3%
Avg.	104.9%	90.6%	195.5%	51.5%	54.6%

Source: Strategas Research Partners LLC

A common misconception about dividend-paying companies is that dividends come at the cost of growth. However, research indicates that companies with higher dividend payout ratios actually have generated higher earnings growth rates over subsequent ten-year periods¹. Given the current environment of slow economic growth, historically low interest rates and the expectation of future inflation, investors are seeking solace in dividends.

Many are turning to dividends as a supplement to the dwindling income provided by bonds. After all, a fixed rate bond will pay the same coupon offered today until maturity. Inflation threatens to erode the value of that fixed coupon over time. On the other hand, companies that pay dividends can raise prices and increase dividends to offset the impact of inflation.

... BUT DIVIDENDS ARE NOT A PANACEA

Investors who focus exclusively on high current dividends can miss potential recovery and dividend growth opportunities. A high dividend yield (calculated by dividing a company's annual dividend by its share price) can also be a sign of trouble. Distressed companies may pay hefty dividends in an effort to defend its stock price and dissuade investors from selling. In other cases, companies with a long-celebrated history of increasing dividends will monetize or choose not to invest in assets just to maintain their strong dividend records. This is not always a wise or sustainable allocation of capital.

¹ Source: Robert D. Arnott and Clifford S. Asness, Financial Analysts Journal 2003



FOCUS ON DIVIDEND POWER

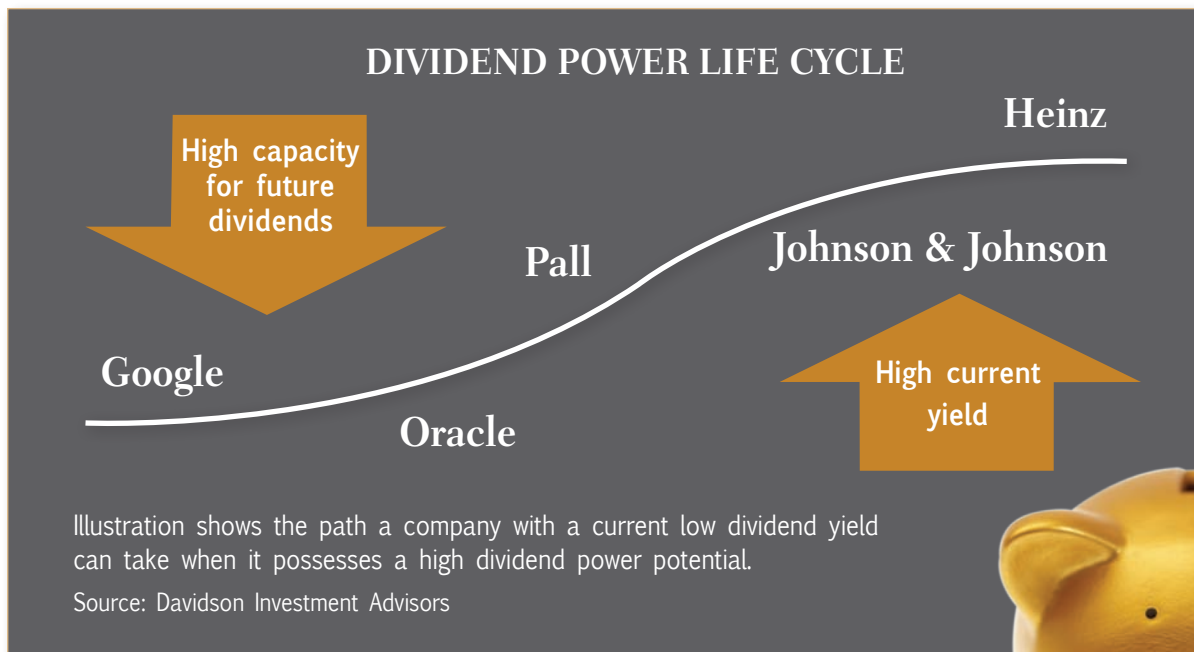
At Davidson, we suggest that investors focus on “dividend power.” As a primary tenet for our Equity Income strategy, dividend power considers a company’s ability to *generate* value and not just its policy to *distribute* value to shareholders. Information about this strategy can be found at www.davidsoninvestmentadvisors.com.

Dividend power relies on the *sustainable* cash earnings generated by a company. Importantly, dividend power extends beyond current dividend yield to include the future capacity for dividends. As such, there are occasions to invest in companies that currently exhibit low or no current yield but possess high dividend power potential. This does not diminish the importance of dividends, but rather places an emphasis on the allocation of capital, return on investment and future dividends.

Dividends provide the benefit of “reminding” management that they are not the sole owners of the company. Dividends reinforce the notion that capital is precious and that reinvestment must be judiciously evaluated among alternatives. Caution must be exercised when dividend policy dictates the allocation of capital. Investors will be best served in the long run to seek companies and managements that sustain and increase dividend power.

Ed Crotty is Chief Investment Officer & Portfolio Manager for Davidson Investment Advisors, a wholly owned subsidiary of employee-owned Davidson Companies.

All investments involve risk. Past performance may not be indicative of future results.



Are you affected by new tax reporting rules?

You probably understand by now that Internal Revenue Service regulations are changing how financial firms, including D.A. Davidson & Co., must report an investment's cost basis for 1099-B reportable transactions. Beginning January 1, 2011, all brokerage firms are required to maintain cost basis information related to covered equity securities shown on the new Form 1099-B and report that information to the IRS. In February 2012, investors will receive the new version of Form 1099-B, which will include details on cost basis, holding period, whether the shares are "covered" (subject to cost basis reporting), acquisition date and disallowed losses.

Starting on January 1, 2012, and again in 2013, cost basis reporting requirements will be expanded to include additional types of securities. The three-year transition for the new regulations is described below.

COVERED VS. NONCOVERED SECURITIES

"Covered" securities, which are subject to the new cost basis reporting requirements, are those purchased on or after their applicable January 1st effective date. Specifically, the new regulations are phasing in over three years, for the specified securities as follows:

- January 1, 2011: Stock in a corporation (other than stock in a regulated investment company (RIC) or stock acquired from a dividend reinvestment plan (DRIP)).
- January 1, 2012: Mutual funds, ETFs and shares acquired through a dividend reinvestment plan.

- January 1, 2013: Other securities designated by the IRS (including fixed income securities).

Noncovered securities are those purchased before the effective dates above. These are not subject to the new cost basis reporting requirements. Responsibility for reporting cost basis and gains/losses on these transactions are the clients.

SPECIFY SHARES TO SELL IF YOU ARE CONCERNED ABOUT COST BASIS AND RESULTING GAINS OR LOSSES

When selling stock, unless you tell your Financial Consultant which shares you want to sell before any trade settlement, D.A. Davidson will use a "first-in first-out" method to determine which shares are sold. Contact your Davidson Financial Consultant for any exception to this reporting method. Davidson does not offer tax advice. We urge you to work with your tax professional before executing any sale.

1099-B CHANGES

If you sold stock shares on or after Jan. 1, 2011 (except within dividend reinvestment plans), Davidson is required to report cost basis, holding period, disallowed losses from wash sales and proceeds on the 1099-B — so the form may look different than what you've seen before.

Please see <http://taxreporting.dadavidson.com> for more information about cost basis, Form 1099-B and related issues.