

# A Fresh Look at Dividend-Paying Stocks

If you don't have any dividend-paying stocks in your portfolio, it may be time to consider including some. After all, dividend-paying stocks provide a source of income that can grow over time. And dividends have a meaningful impact on total return, sometimes helping limit the impact of declines in share price.

Companies are not obligated to pay dividends, and those that don't may instead choose to reinvest their earnings in their businesses. Companies that pay annual dividends often have sufficient earnings to reward their shareholders and to invest in plans for future growth.

## What to Look For

When comparing dividend-paying stocks, investors should pay attention to dividend yield. This figure represents a company's total dividends per share over the last four quarters expressed as a percentage of its current stock price. However, the financial health of the company and its future prospects should also be examined carefully.

## Why Dividends Are Important

Dividends may provide investors with a steady stream of income. Investing in companies that are likely to increase their dividend payments over the years can help a long-term investor's income keep pace with inflation. That's a particularly important consideration for retirees who no longer rely on a salary and regular pay increases.

In addition, dividends can have a substantial impact on an investment's total return – regardless of the investment climate. When stock values are rising, dividends help boost returns. During periods when stock prices are falling, dividends can help cushion overall losses.

Investors who don't need a regular income stream typically reinvest their dividends. Over time, the multiplier effect of this strategy can be significant. According to Standard & Poor's, the annualized total return of the S&P 500 Index from January 1926 to December 2006 was 10.5% per year, including both capital appreciation and dividends reinvested.\* The dividend component was 40.63% of the return.

## A Word on Taxes

For federal tax purposes, dividends used to be treated as ordinary income and taxed at the investor's ordinary income-tax rate. Now, qualified dividends are taxed at the same rates as long-term capital gains. In 2007, the maximum rate on qualified dividends is 15% for taxpayers in a regular tax bracket greater than 15% and 5% for taxpayers in the 10% and 15% tax brackets. The 5% rate that applies in the lower brackets drops to 0% in 2008-2010. The favorable dividend rates are set to expire after 2010.

## Don't Rush In

Dividend-paying stocks can be a smart addition to the portfolios of many investors. However, be sure to contact us at Bay Trust Company before you make a decision about adding to your holdings. Our experienced investment professionals can help you choose the investments that are right for you.

\* Past performance is no guarantee of future results.

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