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## Dividend Investing in a Bear Market

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Model Portfolio Strategist:  
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- **We are currently in a cyclical bear market (since October 2007) and a secular bear market (since 2000).** In this report we will explain the difference between the two and describe why we believe dividend investing can be an effective investment strategy in a secular bear market. We will also discuss why we believe cyclical downturns can provide unique advantages for long-term dividend-oriented investors. We also demonstrate how dividends have positively impacted returns during the Great Depression and our current secular bear market.
  
- **We believe a dividend-based investment approach can be an effective strategy in secular bear markets for long-term investors.** A dividend based approach involves investing in a diversified portfolio of stocks that provide stable dividend payments at attractive yields. Dividends provide income in down and flat markets, which can be reinvested and compounded over time.
  
- **In our opinion, significant cyclical market declines (like the current one) provide a unique investment opportunity for dividend-oriented investors:**
  - ⇒ Market pullbacks create attractive dividend yields and new high-yield opportunities.
  - ⇒ Reinvesting dividends from stocks with attractive yields can have a material positive impact on long-term returns even in a flat stock market.
  - ⇒ Dividend reinvestment in stocks selling at depressed prices can significantly enhance capital gain potential when the market eventually moves into recovery mode.
  
- **Dividends provided a significant benefit to long-term investors during and following the Great Depression.** It took more than 25 years (1929-1954) for the market to get back to the level reached before the 1929 crash. Including dividends in the equation tells a much different story. In fact, during the 25 year period that it took stock prices to get back to break-even, an investor who invested \$100K and reinvested dividends would have seen his portfolio grow to \$431K (a return of 331%).
  
- **Dividend stocks have out-performed the S&P 500 since the beginning of the current secular bear market.** Over the last nine years (3/00 - 3/09), the total return for the S&P 500 was negative 37.4% (-5.1% annualized), while the DJ Dividend Index had a total return of positive 34.0% (3.3% annualized). This leads us to conclude that the core cash return that dividends provide become more of a relevant factor in periods of multiple contraction (secular bear) than in periods of multiple expansion (secular bull).

*Please Note: For important disclosures, including potential conflicts of interest, please see the last page of this publication.*

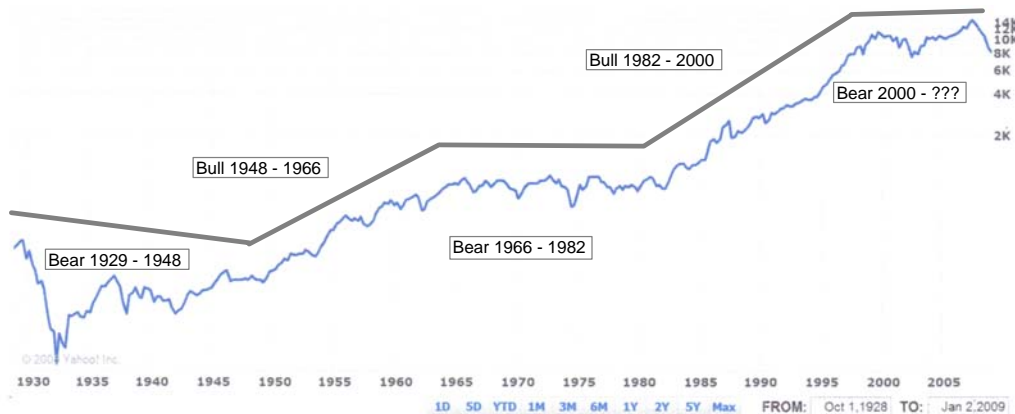
## Dividend Investing in a Bear Market

As of March 31, 2009 the price level of the S&P 500 Index was down 40% over the last year and 38% below the level it traded at ten years earlier. This is a strong indication that we are in both a cyclical bear market and a secular bear market. In this report we will explain the difference between the two and describe why we believe dividend investing can be an effective investment strategy in a secular bear market. We will also discuss why we believe cyclical downturns can provide unique advantages for long-term dividend investors. We then demonstrate how dividends have positively impacted returns during the Great Depression and our current secular bear market. Finally, we provide some potential dividend investment strategies.

### What exactly is a Secular Market?

The stock market has historically gone through long-term trends that can last more than two decades. Referred to as secular markets, these trends often reflect long-term social and geopolitical events which impact market valuation.

Dow Jones Industrial Average 1928 - 2008



Source: Ameriprise Advisor Services Inc., CSI

A secular market reflects a long-term trend in valuation, which can last up to two decades.

A **secular bull market** will begin at historic low earnings multiples and usually occurs during times of prosperity, peace, and optimism and provides investors with robust capital appreciation over long-term periods. The roaring 20s, the post World War II economic boom, the end of the cold war, and the technology boom all occurred during secular bull markets. Overall, businesses do well and people generally feel good, which results in a multiyear upward trend in market valuation and relatively low market volatility.

Cyclical markets are shorter-term in nature and revolve around the rise and fall of the economic cycle.

On the other hand, a **secular bear market** will begin at historic high earnings multiples and usually occurs during long-term periods of stress, turmoil, and political changes. Historic events such as World War I, the Great Depression, World War II, the Vietnam War, the fight for civil rights, and the 1970s oil embargo, all occurred during secular bear markets. In periods like this, investors' long-term views are less optimistic, which results in a long-term downward trend in market valuations. A secular bear market will usually contain one or more major market corrections.

Secular markets are different than **cyclical markets** which are shorter-term (one to five years) and usually revolve around the rise and fall of the economic cycle. Cyclical markets reflect economic

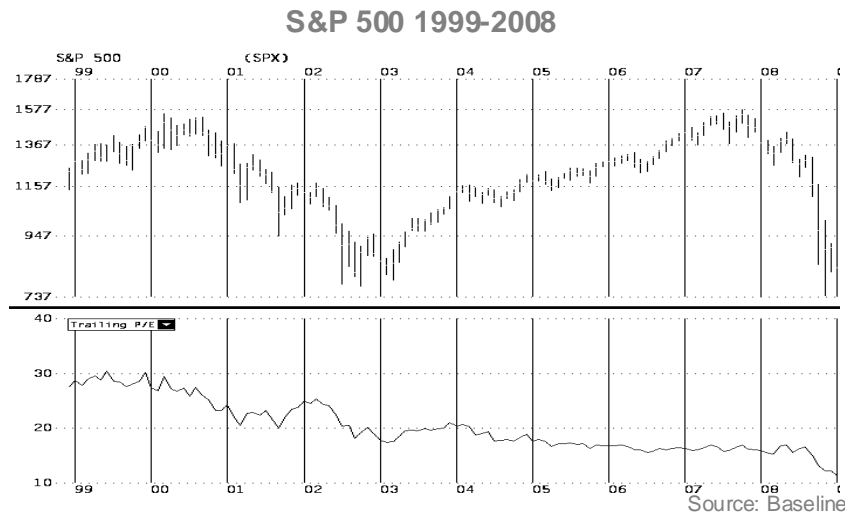
changes in corporate earnings, while secular markets reflect long-term trends in valuation. Secular markets often contain multiple cyclical markets. For example, the crash of 1987 and the 90-91 recessions occurred during our last secular bull market (1982 - 2000).

### Today's Market Environment

Given the considerable decline in the stock market there is no doubt we are in a significant cyclical bear market which began in October 2007. The collapse in real estate values and the subsequent credit crisis have created a world-wide recession. Last year the S&P 500 experienced its largest decline since 1932. Additionally, market volatility and interest rate spreads are also the highest since the 1930s.

We are also in a secular bear market that began in 2000. Since then, we have experienced the bursting of the technology bubble, 9/11, the Iraq war, and more recently the bursting of the real estate bubble and subsequent financial crisis. This has caused a downward trend in market valuation.

The consistent decline in the Price/Earnings ratio of the S&P 500 shows that we have been in a secular bear market since 2000.



The top half of this chart represents the price of the S&P 500 and the bottom half represents valuation measured by price-to-earnings ratio. Note that valuation has been in a steady downward trend even during the cyclical bull market of 2003-2007. The end result has been more than a decade of negative return.

### The Importance of Dividends in a Secular Bear Market

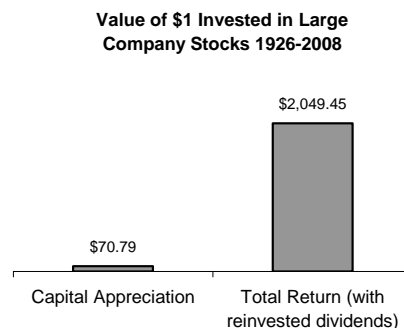
We have just experienced the largest single year market decline since the Great Depression; the economic news appears to be moving from bad to worse; and there is a large degree of uncertainty going forward. Couple with this the fact that we are in a long-term secular bear market which could last another 10 years or more; the question becomes ....**Why be invested in the market at all?**

**We believe that a dividend-based investment approach can be an effective strategy in secular bear markets for long-term investors.** A dividend based approach involves investing in a diversified portfolio of stocks that provide stable dividend payments at attractive yields. Dividends provide

income in down and flat markets, which can be reinvested and compounded over time. Furthermore, we believe significant cyclical market declines provide a unique investment opportunity for dividend-oriented investors with a long-term time horizon.

**Dividends and Total Return**

Simply put, stock prices are determined by earnings and valuation (what others are willing to pay for those earnings). When the economy makes earnings improvement difficult and the perceived value of earnings is in a long-term downward trend, stock price appreciation is hard to come by. However, there is a third and very important component of investor total return that a price chart won't show ...DIVIDENDS.



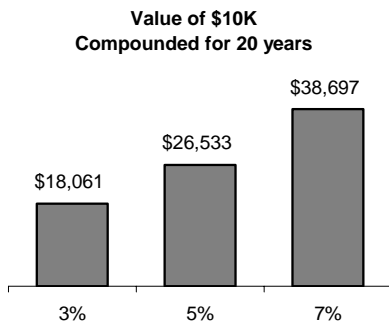
Source: Ameriprise Advisor Services, Inc., Ibbotson SBBI

According to Ibbotson, \$1 invested in stocks at the end of 1925 would have grown to \$2049 by year-end 2008. Excluding the impact from dividends that same \$1 would only be worth \$71.

The cash return that many stocks offer should not be taken lightly. In fact, over time **dividends and the reinvestment of dividends have had a material impact on wealth creation**. According to Ibbotson, one dollar invested in large company stocks at year-end 1925, with dividends reinvested, grew to \$2,049.45 by year end 2008 (a compound annual growth rate of 9.6%). However, if we took dividends out of the equation, and relied solely on capital appreciation, the same dollar would only be worth \$70.79 (a compound annual growth rate of 5.3%).

**Dividends Offer Compounding Opportunity**

We have noted that during secular bear markets, stock prices can extend as much as two decades with very little or even negative price appreciation. In such an environment, dividend paying stocks have a significant advantage over non-dividend paying stocks --- cash return year in and year out. This cash dividend can be re-invested to create a compounding effect.



Source: Ameriprise Advisor Services, Inc.

The higher the dividend yield, the greater the compounding opportunity.

Obviously, the higher the dividend yield, the greater the compounding effect. For example, \$10K invested for 20 years in a stock with a 3% stable dividend would be worth \$18.1K in 20 years just from the compounding effect of the dividend. However, that same \$10K invested in a stock with a 7% yield would be worth \$38.7K. It is important to note that higher yield is often, but not always, associated with greater risk of a dividend cut or reduction. Therefore the highest yielding stocks are not always the best investments; underlying fundamentals must be considered.

**Major Cyclical Declines Create Opportunities**

Cyclical bear markets can be frustrating and emotional, and many investors end up panicking and selling at the worst time (at or near to bottom). Historically, all majors cyclical declines (30% or more) have happened during secular bear markets. **Believe it or not, major market declines create opportunities for long-term dividend investors.**

**Attractive Yield Opportunity**

The current market pullback has created attractive dividend yields. The yield on the S&P 500 (currently at 3.2%) is the highest since 1990 and the Dow Jones Select US Dividend index has a yield of 5.9%, almost twice the yield it was offering last year at this time. As mentioned previously, the compounding effect of a couple percentage points can have a material impact on long term total return.

**Dividend Reinvestment at Depressed Prices**

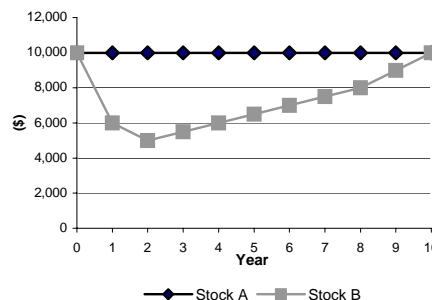
Reinvesting dividends at depressed stock prices can have a material positive impact on long-term returns. For example, suppose an investor invests \$10K each into two stocks and plans to hold them for 10 years. Both stocks pay a stable 5% dividend yield, which will be reinvested at the end of each year.

We will assume Stock A's price remained unchanged during the entire 10 year period. On the other hand, the share price of stock B plummeted 40% the first year and another 17% during the second year, but was able to claw its way back to break-even by the end of year 10. We will also make the assumption that both stocks were able to maintain dividend payments.

The Dow Jones Select Dividend Index currently has a dividend yield of 5.9%.

Dividends reinvestment at depressed prices can significantly enhance capital gain during a market recovery.

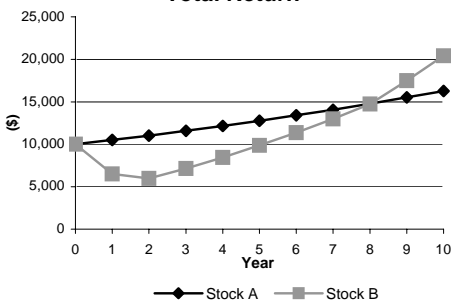
Capital Appreciation



Source: Ameriprise Advisor Services, Inc.

At the end of 10 years, both stocks provided zero capital appreciation, and without dividends, both would have generated zero total return for an entire decade. Through the contribution of the dividends and power of dividend reinvestment, the value of the Stock A investment grew to \$16.2K (a total return of 62.9%). Not bad, considering there was no price appreciation. However, the value of Stock B was 26% greater, \$20.4K for a total return of 104%. The Stock B investment actually benefited from the significant price decline because the dividend was reinvested at lower stock prices allowing the purchase of a greater number of shares. (See appendix A for a more detailed analysis of these return computations).

Total Return



Source: Ameriprise Advisor Services, Inc.

As demonstrated above, **a major pullback in a stock that pays a stable dividend is actually a positive for an investor with a long-term time horizon.** Furthermore, the additional shares added through dividend reinvestment enhance the impact of share price recoveries.

**Capital Gain Potential**

It is true that investors in secular bear markets generate little capital appreciation from beginning to end. However, this is not true if investing from a low point (or trough) of the secular bear market. Major bottoms are formed in cyclical bear markets within secular bear markets.

For example, returns for years following trough years (1932 and 1974) during our last two secular bear markets significantly out-performed the market’s long-term average return over both the short-term (5 years) and long-term (20 years). We realize it is impossible for anyone to determine a market bottom when one hits. However, the point we are making is that above average capital gains are possible even in the middle of a secular bear markets, despite a less than stellar underlying economy.

Historically, returns following market troughs have significantly out-performed the market’s long-term average.

Trough Year	Subsequent Year Total Return					Average	
	1933	1934	1935	1936	1937	5 yr.	20 yr.
1932	54.0%	-1.4%	47.7%	33.9%	-35.0%	14.3%	13.2%
1974	37.2%	23.8%	-7.2%	6.6%	18.4%	14.8%	14.6%
Average Large Company Total Return 1926-2008							9.60%

Source: Ameriprise Advisor Services, Inc., Ibbotson SBBI

We have just listed several reasons why incorporating a dividend investment approach can be an effective strategy in a secular bear market. Over the next couple of pages, we will use actual historical data to show the positive impact that dividends have had during secular bear markets.

**Total Return during the Great Depression**

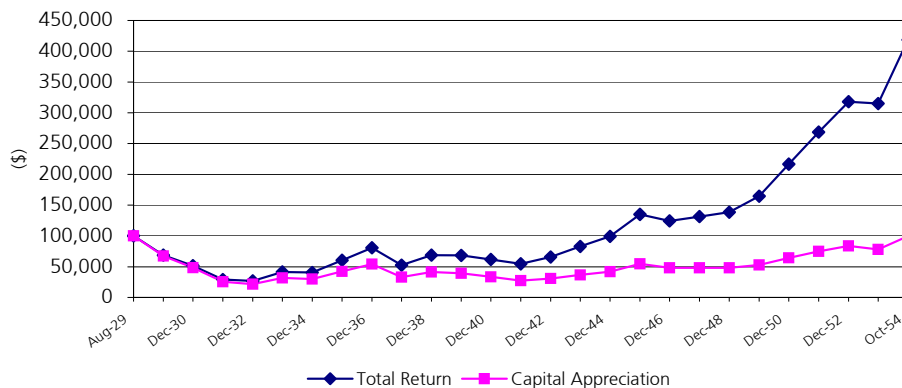
To demonstrate the impact dividends have had on return, we can look at the worst economic period our country has ever faced, “The Great Depression”, which started with the stock market crash of 1929. From the high in August 1929 to the low in February 1933 the market declined more than 85%. It took more than 25 years (1929-1954) for the market to get back to the level reached before the 1929 crash.

From August 1929 through October 1954, the stock market experienced zero capital appreciation. However when dividend and dividend reinvestment is considered, the total return during that period was more than 330%.

For this analysis, we used data obtained from Ibbotson Stock, Bonds, Bills, and Inflation 2008 Classic Yearbook (Ibbotson SBBI), which provides market return data from 1926 through 2007. In all cases, we are referring to Large Company stock returns, which reflect returns from the S&P 500 Index from 1957-2008 and the S&P 90 index from 1926-1957. Our chart assumes \$100k was invested at the end of August 1929 through October 1954. We chose the end date because that was the break-even month in terms of stock prices.

Market indices only measure capital appreciation and do not account for dividends. Including dividends in the equation tells a much different story. Based on Ibbotson SBBI total return data, an investor would have been back to break-even by 1944, a full ten years earlier, when dividends and dividend reinvestment is considered. In fact, during the 25 year period that it took stock prices to get back to break-even, an investor who invested \$100K and reinvested dividends would have seen his portfolio grow to \$431K (a return of 331%). This is despite the fact that dividends declined materially from the market peak in 1929 to the trough in 1933.

Large Company Stocks (8/29 - 10/54)



Source: Ameriprise Advisor Services, Inc., Ibbotson SBBi

An investor that entered the market at the end of 1932 would have experienced a return of more than 1,600% through October 1954 if dividends were reinvested.

We earlier mentioned that investing near the trough of a secular bear market can offer the potential for above average total return. Based on the same data, an investor lucky enough to invest in the market at the end of 1932 (the trough), which was near the low point during the depression, saw capital appreciation of more than 400% through October 1954. However, including the impact of dividends, the total return for the same period would have been more than 1,600%.

### What Have You Done For Me Lately?

Investing in stocks was a bit different in the 30's than it is today. Back then, dividends were expected by investors and payout ratios were high, relative to today's standards. The average yield during the 20s and the 30s ranged between 5% and 9%. During the last secular bull market (1982-2000), dividend yields gradually declined to an all time low, as valuations increased and investors became more interested in capital gains, to the point that in 2000 the dividend yield on the S&P 500 was barely over 1%.

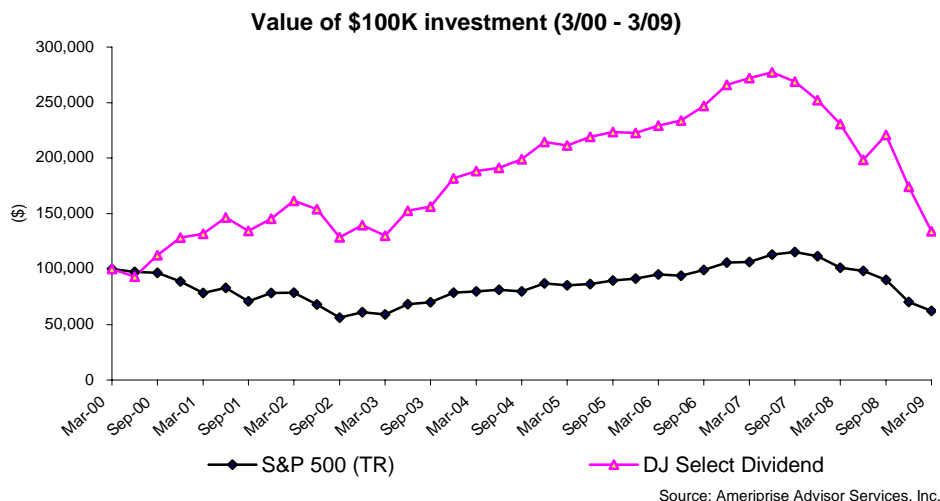
The Dow Jones US Select Dividend Index has outperformed the S&P 500 Index by a significant margin since 1992.

To get an idea of how a dividend investing strategy would have worked in recent years, we can look at the **Dow Jones US Select Dividend Index**, which got its start in 2003 (but supplies back-tested data from March 1992). The index universe is defined as all dividend-paying stocks in the Dow Jones U.S. Market Index (attempts to represent 95% of all U.S. publicly traded companies), with a non-negative dividend growth rate over the last five years, and a payout ratio of less than or equal to 60%. The 100 top dividend yielding stocks are selected for the index. The index is dividend-weighted (largest dividend payers get largest weighting) and is reviewed each December.

According to return data obtain from Bloomberg, over the last seventeen years (3/92 - 3/09) the S&P 500 Index provided an annualized total return of 6.1%. During the same period the Dow Jones US Select Dividend Index (DJDVY) posted an annualized return of 8.9%. Put another way, a \$100K investment in the DJDVY would have grown to \$424K during that period, compared to \$276K had it been invested in the S&P 500.

It is important to note that the out-performance happened once the secular bear market began in March 2000. Since that point (3/00 - 3/09), the total return for the S&P 500 was negative 37.4% (negative 5.1% annualized), while the DJ Dividend Index had a total return of positive 34.0% (3.3% annualized). This leads us to conclude that the core cash return that dividends provide become more of a relevant factor in periods of multiple contraction (secular bear) than in periods of multiple expansion (secular bull).

The Dow Jones US Select Dividend Index has out-performed the S&P 500 by an average of 840 basis points annually since the beginning of the current secular bear market.



### Employing a Dividend Investment Strategy

Individuals who wish to start investing with a dividend-centric philosophy have many choices. One solution is to invest in a diversified portfolio of stocks that offer attractive dividends. However, this approach requires a certain level of research and investment expertise to both initiate and maintain the strategy. Another solution that may be easier for some investors is to invest in a mutual fund that employs a dividend strategy, and reinvest dividend payouts. Many fund companies offer a solution like this. A more quantitative approach is to invest in Exchange Traded Funds (ETFs) that attempt to mirror various dividend indices. Several dividend-oriented ETFs have been introduced in recent years.

For those investors that have cash on the sidelines and are looking to re-enter the market, we recommend employing a dollar cost averaging strategy. In our opinion, the current secular bear market could last several more years. During a secular bear, stocks tend to experience periods of significant volatility. By investing a fixed dollar amount at regular intervals, investors can significantly reduce market timing risk.

### Risks

Past performance is no guarantee of future results. With equity investing both investment return and principal value can fluctuate and investors may experience a loss of principal. Equity markets in general could sustain significant volatility due to several factors, including but not limited to changes in economic situations, interest rates, natural disasters, and changes in tax law, competitive environment, geopolitical issues, and other regulatory issues. You may experience a loss of principal following this strategy.

*Appendix A (see page 5)*

**Dividend Investing in a Flat Market**

Year	Beginning			Dividend				Ending		
	Price	Shares	Value	Yield	\$/shr	total	shrs	Price	Shares	Value
1	100	100	10,000	5%	5	500	5	100	105	10,500
2	100	105	10,500	5%	5	525	5	100	110	11,025
3	100	110	11,025	5%	5	551	6	100	116	11,576
4	100	116	11,576	5%	5	579	6	100	122	12,155
5	100	122	12,155	5%	5	608	6	100	128	12,763
6	100	128	12,763	5%	5	638	6	100	134	13,401
7	100	134	13,401	5%	5	670	7	100	141	14,071
8	100	141	14,071	5%	5	704	7	100	148	14,775
9	100	148	14,775	5%	5	739	7	100	155	15,513
10	100	155	15,513	5%	5	776	8	100	163	16,289
<b>Total Return</b>										<b>62.9%</b>
<b>Yield on Investment</b>										<b>7.8%</b>

**Dividend Investing in a Down Market**

Year	Beginning			Dividend				Ending		
	Price	Shares	Value	Yield	\$/shr	total	shrs	Price	Shares	Value
1	100	100	10,000	5%	5	500	8	60	108	6,500
2	60	108	6,500	8%	5	542	11	50	119	5,958
3	50	119	5,958	10%	5	596	11	55	130	7,150
4	55	130	7,150	9%	5	650	11	60	141	8,450
5	60	141	8,450	8%	5	704	11	65	152	9,858
6	65	152	9,858	8%	5	758	11	70	163	11,375
7	70	163	11,375	7%	5	813	11	75	173	13,000
8	75	173	13,000	7%	5	867	11	80	184	14,733
9	80	184	14,733	6%	5	921	10	90	194	17,496
10	90	194	17,496	6%	5	972	10	100	204	20,412
<b>Total Return</b>										<b>104.1%</b>
<b>Yield on Investment</b>										<b>9.7%</b>

Source: Ameriprise Advisor Services, Inc.

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