



## Important Topic: Questioning the Tendency to Favour Dividends

Investors tend to favour companies that pay a regular dividend over those that do not. I would like to question that.

It is most important to realize that all of the company's cash flows are from the same source: company profits.

Profits are either (i) re-invested in the business generating incremental value, or they are distributed to shareholders via (ii) dividends or (iii) share buybacks. Let us consider all three of these after noting that, unsurprisingly, profitability is paramount (remember this the next time someone tries to convince you to invest in an unprofitable company).

### (i) Reinvestment

If a company has the opportunity to invest its profits in projects that play to its strengths and offer attractive returns (new product, acquisition), they should do so. If successful, the result will be an increase in the share price which is taxed as capital gains. Capital gains are taxed at a rate 50% lower than the rate on interest or employment income and 37% lower than on dividends. Also, capital gains are only taxed when the position is sold.

### (ii) Dividends

Taxed upon receipt, dividends are favoured as they provide regular cash flow. While it is almost always more tax efficient to sell positions and realize a capital gain, dividends are simpler.

Some investors choose to reinvest the dividends in additional shares through Dividend Reinvestment Programs (DRIP), which has the same result as the company reinvesting the money themselves, just less tax efficient.

### (iii) Share Buybacks

Companies use their profits to purchase and cancel shares. This results in fewer shares outstanding, increasing the value of all remaining shares. Remaining shareholders now receive a larger percentage of the profits and own more of the company. The result should be a capital gain.

Many companies are buying back shares opportunistically, buying when the traded price is attractive relative to the underlying value of the business.

The simple fact is that, in the past, the principal way public companies returned earnings to their shareholders was via dividends. Today this is no longer the case. Share buybacks have been gaining traction over the past thirty years. For the S&P500, there was \$14 billion of share buybacks in 1980, and \$572 billion in 2015. (Credit Suisse)



## Summary

What truly matters is that a company generates healthy cash profits. How they return these profits to shareholders is secondary with some ways being more tax efficient than others.

## Market Update – October 2019

October proved to be a mixed month in the markets but with some stock indices hitting new all-time highs. Markets were led by gains in Emerging Markets and International Markets followed by the US while the Canadian market and bond market fell.

While the economy advanced, any disappointing news was shrugged off by investors seemingly convinced that the central banks would lower interest rates if needed.

Overall earnings (profits) have been above expectations, providing some justification for higher stock prices.

Year-to-date, the markets have remained strong, posting attractive gains.

Looking forward, we believe the economy has stabilized, political uncertainty and volatility remains high (and likely will for the foreseeable future), and inflation remains benign.

As a result, we are neutral in the short term, but positive in the medium and long term. We continue to hold our positions and invest cautiously.

For the Month, the bond market was down 0.2%, the Canadian market was down 0.8%, the US market was up 2.0%, International markets were up 3.3%, the Emerging markets were up 3.5%, the Real Estate market was up 2.3% and the preferred market was up 0.1%. (Reuters 10/31/19)

Year-to-date, the bond market is up 7.8%, the Canadian market is up 17.3%, the US market is up 18.7%, International markets are up 15.4%, the Emerging markets are up 5.7%, the Real Estate market is up 22.5% and the preferred market is down 1.0%. (Reuters 10/31/19).

Have a great month and let us know if there is anything we can do for you,

Meir

### Meir J. Rotenberg, MBA, CFA®

Vice President & Investment Advisor  
meir.rotenberg@td.com

### Adam D. Shona, B.Comm

Associate Investment Advisor  
T: 416 512 7645  
adam.shona@td.com

### Nelson Gordon

Client Service Associate  
T: 416 512 6813  
nelson.gordon@td.com

### TD Wealth Private Investment Advice

5140 Yonge Street, Suite 1600  
North York, Ontario M2N 6L7  
T: 416 512 6689

**TD Wealth**

**Ready  
for you**



The information contained herein has been provided by TD Wealth Private Advice and is for information purposes only. The information has been drawn from sources believed to be reliable. The information does not provide financial, legal, tax or investment advice. Particular investment, tax, or trading strategies should be evaluated relative to each individual's objectives and risk tolerance. Prices, yields and availability subject to change; rate of return assumes held to maturity.

Certain statements in this document may contain forward-looking statements ("FLS") that are predictive in nature and may include words such as "expects", "anticipates", "intends", "believes", "estimates" and similar forward looking expressions or negative versions thereof. FLS are based on current expectations and projections about future general economic, political and relevant market factors, such as interest and foreign exchange rates, equity and capital markets, the general business environment, assuming no changes to tax or other laws or government regulation or catastrophic events. Expectations and projections about future events are inherently subject to risks and uncertainties, which may be unforeseeable. Such expectations and projections may be incorrect in the future. FLS are not guarantees of future performance. Actual events could differ materially from those expressed or implied in any FLS. A number of important factors including those factors set out above can contribute to these digressions. You should avoid placing any reliance on FLS.

TD Wealth Private Investment Advice is a division of TD Waterhouse Canada Inc., a subsidiary of The Toronto-Dominion Bank. All trademarks are the property of their respective owners. © The TD logo and other trade-marks are the property of The Toronto-Dominion Bank.