



Carla Pasternak's

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## The Safest Dividend in the S&P

-- By Carla Pasternak

Sixty-one of the companies in the S&P 500 Index cut their dividends in 2008, equating to \$40.6 billion in lost dividend income. Standard and Poor's itself has projected a -13.3% decline in dividends for the entirety of 2009 -- the worst drop since World War II.

But that doesn't mean every stock in the index is ready to slash its payments. I've taken a look at every single company in the S&P 500 and arrived at what I think is "The Safest Dividend in the S&P." (*Full Story Below*)

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### The Safest Dividend in the S&P

A [few months ago](#), I clued readers in to what I saw as "The Safest Dividend in the Dow." As you'll remember, I tagged Verizon (NYSE: VZ) with the award, based on its stability in the bear market, solid dividend coverage and 6.3% yield.

The response to my article was overwhelming, and readers have wanted even more. So I'm taking the rigorous metrics I applied to find the safest dividend in the Dow and using them to uncover the safest dividend in the S&P 500!

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In short, it's more important than ever to take a hard look at dividend safety before you invest for income. That's where I want to help.

To find the safest dividend in the S&P, I'm going to look at the same metrics I used for the Dow: yield, earnings power, dividend coverage and track record. Let's see what we uncover.

### Income Notes

14.2%

Yield of Frontier Communications, making it the highest-yielding stock in the S&P 500.

140

Number of stocks in the S&P 500 that pay no dividends.

-- Research Staff

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## Safety Criteria #1: Yield

When it comes to yield, it usually takes something above 6% to garner even a second look from me. So let's start with all the stocks within the S&P 500 that yield above that magic 6.0% number.

As I suspected, it turns out the common stocks in the S&P 500 don't offer much in the way of yields overall, but you can still find a few individual companies offering attractive payments.

In total, 18 stocks in the S&P (only 3.6% of the total) yield above 6.0%. Of those, the highest-yielding stock is Frontier Communications (NYSE: FTR), which pays investors 14.2% a year.

With these stocks in focus, I'll now turn to my next metric to uncover the safest dividend in the S&P: earnings power.

## Safety Criteria #2: Earnings Power

It's not uncommon for "sick" stocks to carry high yields. Based on a poor outlook, investors will dump the shares, boosting the yield. To combat this potential pitfall, I'm looking at the 1-year growth in operating income for each of the 18 stocks with a yield above 6.0%.

Operating income is the profit realized from the company's day-to-day operations, excluding one-time events or special cases. This metric usually gives a better sense of a company's growth than earnings per share, which can be manipulated to show stronger results.

Given the downturn in the economy, I searched for companies on my high-yield list able to manage any growth in operating income over the last year, indicating the business was still able to thrive in one of the worst recessions in recent memory. After screening for positive 1-year growth in operating income, I'm left with the seven candidates shown in my table:

Company	OI Growth	Yield
Integrus Energy (NYSE: TEG)	+54.4%	8.0%
Pepco (NYSE: POM)	+10.9%	7.6%
Reynolds American (NYSE: RAI)	+1.9%	7.5%
Altria (NYSE: MO)	+26.0%	7.1%
HCP Inc. (NYSE: HCP)	+9.8%	6.9%
Health Care REIT (NYSE: HCN)	+9.9%	6.8%
DTE Energy (NYSE: DTE)	+25.7%	6.2%

## Safety Criteria #3: Dividend Coverage

No measure of dividend safety carries as much weight as the payout ratio. By comparing the amount of operating profit earned against how much is paid in dividends, we can know whether a company can continue paying its current yield, even if conditions worsen.

You can see from my table that only five companies were left after I checked for sustainable payout ratios during the most recent quarter. Altria, Reynolds American, and DTE Energy all carry conservative payout ratios below 70%. HCP Inc. and Health Care REIT sport higher ratios, but both of these are REITs required by law to pass the bulk of their income to investors. It's not unusual for their payout ratios (which are based on funds from operations) to be higher.

Company	Payout Ratio*
Altria (NYSE: MO)	38%

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Reynolds American (NYSE: RAI)	38%
Health Care REIT (NYSE: HCN)	91%
HCP Inc. (NYSE: HCP)	84%
DTE Energy (NYSE: DTE)	66%
*Payout ratio for the most recent quarter, according to Bloomberg. Based on operating income for MO, RAI, and DTE. Based on funds from operations for REITs HCN and HCP.	

#### Safety Criteria #4: Proven Track Record

Looking into the track records of each of these five companies offers good news for investors -- each one has a solid history. Depending on what you look for in an investment, I'd consider any one of the five to be the safest dividend in the S&P 500.

For example, Altria has offered 5-year annual returns of +15.8% and throws off a 7.1% yield. Reynolds American is trading at a -25% discount to its average 5-year price-to-earnings ratio and has offered +10.0% annual returns since 2004. However, both are manufacturers of cigarettes and tobacco, which many investors choose to avoid.

Instead, Health Care REIT and HCP Inc. both have offered annual returns near the +10% range over the last five years and haven't had a dividend cut since they went public. These two REITS invest in healthcare properties, which may be a more palatable alternative to Altria and Reynolds.

The final stock I uncovered, DTE Energy (NYSE: DTE) operates electric and natural gas utilities in Michigan. Despite tough times in the state, the stock still manages to throw off 6.2% in dividends. You won't see much growth in the company's operations or dividend payments like you'll find with the other four candidates, but for a steady stream of income, DTE looks like a winning candidate.

Good Investing!



*Carla Pasternak's Dividend Opportunities*

P.S. -- The distributions of the five companies I found above look safe, but should only be a starting point for further research. And remember, just because these payments look safe now, doesn't mean they will be forever -- I always keep continual watch of the distributions for every security I hold.

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