



Carla Pasternak's

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## Overcome The Worst News Imaginable for Income Investors

-- By Carla Pasternak

A recent report from Standard and Poor's confirmed the news I've feared since the recession started. Dividends are being cut at a record rate and companies show no signs of increasing them anytime soon.

Luckily, I've been preparing my income portfolios for this situation for more than a year and have a couple of tips -- and one pick -- to combat the surge in dividend cuts. (*Full Story Below*)

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### Overcome the Worst News Imaginable for Income Investors

On July 1st, Standard and Poor's issued the following in a [press release](#):

*"Dividend decreases were posted by 250 issues during the second quarter of 2009, the highest number since the second quarter of 1957, over 50 years ago."*

According to Howard Silverblatt, a senior analyst at S&P, annual dividend increases have outnumbered decreases for as far back as S&P records go -- 1955. But that streak looks like it will end this year.

"It's not a good time for dividend investors," according to Silverblatt.

Judging from this report, you might think income investing is a lost cause. You couldn't be further from the truth.

### Income Notes

Apparel retailer Buckle Inc. said Tuesday its board authorized a \$1.80 per share, one-time, cash dividend paid to shareholders of record on Oct. 15th.

The board also authorized a 20-cent-per-share regular dividend, also to shareholders of record on Oct. 15th.

Both dividends are payable on Oct. 27th and will be paid together.

-- Associated Press

The highest-yielding stocks in the S&P 500 as of September 22nd:

Frontier (NYSE: FTR) -- 13.8%  
Windstream (NYSE: WIN) -- 10.4%  
Qwest (NYSE: Q) -- 9.2%  
CenturyTel (NYSE: CTL) -- 8.9%  
Integrus (NYSE: TEG) - 7.6%

-- Research Staff

### Breaking News

[The Three Best-Covered High Yields in the S&P](#)

For example, the portfolios in my premium [High-Yield Investing](#) newsletter have rarely seen better days. I informed readers a [few weeks ago](#) that every single one of my current holdings was showing a gain. As of my latest update I did have one pick in the red -- it was down -0.3%. Moreover, my holdings yield as high as 12.9%. And only two of the 23 positions yield less than 6%.

So you can see it's possible to make this environment a great time for income investing, but now -- more than ever -- you have to focus on dividend safety. The question is, with so many stocks cutting payments, how can you get any sense for the safety of the dividend?

#### Two Tricks to Find Safety

The first trick I use is an old standby of income investors -- the payout ratio -- but with a twist. The payout ratio is simple. Take how much the company earns and divide it by how much it pays in dividends. If a stock earns \$1 per share and pays \$0.50, it has a payout ratio of 50%. Ratios below 80% are generally considered "safe."

But sometimes you have to be a little more sophisticated with payout ratios. Some securities carry unreasonably high ratios if earnings alone are compared to dividends paid. But in the case of shippers or telecoms -- or any company that encounters high depreciation expenses -- a more accurate payout ratio comes from comparing operating cash flow to dividends paid.

This figure can be found on the company's cash flow statement and backs out non-cash charges like depreciation. Depreciation expenses lower earnings for a company, but don't actually affect the cash available for dividends. By accounting for this nuance, investors can have a better sense of the dividend's safety.

#### Income Required by Law

The second technique I'm using to prosper is focusing on securities required to make payments to investors.

Believe it or not, the dividends from common stocks are the least secure of any income investment. These payments are made solely at the discretion of company management. When business goes south, cutting the common dividend is usually the first move made to save cash.

But there are dozens of securities that offer guarantees of payment. For example, real estate investment trusts (REITs) and master limited partnerships (MLPs) are required by law to pass on a bulk of their income to investors.

But one of my favorite legally obligated income streams comes from trust preferred shares. These beauties have many of the same characteristics of bonds, but they trade on the NYSE just like a common stock, making them easy to buy and sell.

As for safety, they can be second-to-none. I picked up shares of Wells Fargo 8.625% Trust Preferreds (NYSE: WCO) in January. These notes are backed by Wells Fargo, which carries a credit rating of "A3" from Moody's and "A" from Standard & Poor's -- indicating little risk of default.

At the height of the financial crisis Wells Fargo had to cut its common dividend by more than -85% to save cash. But the trust preferred shares have kept making their steady payments of \$0.54 per share every quarter (for a current yield of 8.1%) ... and have even risen in price to above their par value. In fact,

These three high-yielding companies don't just pay a big dividend, they pay an extremely safe big dividend.

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#### Trust Preferred Shares

- Can be bought or sold throughout the day on the NYSE.
- Usually issued at a par value of \$25 per share. Investors receive that amount at maturity or if called.
- Fixed payment that can't change at management's discretion.
- Interest payments are debt obligations that must be paid before common share dividends.

since adding WCO to my [High-Yield Investing](#) portfolio, I've gained nearly +20% and don't have to worry about my income stream being crimped.

It just goes to show that by keeping a close eye on safety, right now can still be a great time to be an income investor.

Good Investing!



*Carla Pasternak's Dividend Opportunities*

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