

Look at a Dividend-Paying ETF for Income

IF YOU'RE looking for dividend-payers but don't want to invest in individual stocks, consider one or more of the dozens of income-focused exchange-traded funds. An ETF will offer a diversified portfolio at a low cost.

With increased volatility in the stock market and little yield from bonds, dividend-paying stocks are growing in popularity. Standard & Poor's reports that 391 companies in the S&P 500 index paid dividends as of the end of October, up from 373 at the start of the year. Half of the companies in the index raised payments to shareholders so far this year.

Three of the oldest dividend ETFs are the largest. **iShares Dow Jones Select Dividend Index** (symbol DVY, recent price \$52, 3.6% yield) was launched in 2003 and now holds about \$8.5 billion. **Vanguard Dividend Appreciation ETF** (VIG, \$53, 2.6%), which made its debut in 2006, is slightly larger, with \$8.7 billion. Third in size is **SPDR S&P Dividend ETF** (SDY, \$53, 3.3%), which started in 2005 and holds \$7.2 billion. All holdings of the three are domestic, and most of the holdings are large-company stocks.

Size does matter. Bigger ETFs have more trading volume and have a narrow spread between the "buy" and "sell" prices, reducing the take of intermediary market makers.

Dividend-paying ETFs tend to be less volatile than other equity investments. "If you look at how they performed in 2008, they held up really well," says Jennifer Cole, a financial planner in Sandia Park, N.M. The flip side is that they don't keep pace when stocks soar. They also tend to be cheaper to own than traditional dividend-oriented mutual funds.

On the downside, you may have to pay a brokerage fee to trade ETFs, but Vanguard, Charles Schwab and

other brokerages waive fees on some funds. Also, if you don't want cash dividends, it can be more cumbersome to reinvest with ETFs. In choosing a dividend ETF, look at yield, but note that higher yield could mean higher risk. Also take total return into account.

Although yields of the big dividend ETFs beat the 2% on the ten-year Treasury note, these products should not take the place of bonds in your portfolio. "I don't look at them as a substitute for bonds because they move with the stock market," says Ray Mignone, a certified financial planner in Little Neck, N.Y.

Choosing Dividend Payers

Before you buy a dividend ETF, you should understand how it's constructed. Each has a slightly different methodology, and that results in divergent portfolios. The SPDR and Vanguard ETFs are based on indexes that first screen for number of consecutive years of dividend increases. For Vanguard, it's a minimum of ten years; for SPDR S&P, it's 25.

Meanwhile, iShares Dow Jones' index screens for five-year dividend growth and a payout ratio of 60% or less of earnings. A stock that has not increased for the previous four years and then doubles the dividend in the fifth year could make the cut at iShares but not at the other two, which look for annual dividend growth. For retirees, consistency of increases may be a better bet. To check an ETF's methodology, visit the fund company's Web site.

Before the 2008 financial crisis, many of the holdings of these funds were banks. The funds dropped many banks after they cut their dividends. Financial holdings today are often insurance companies and real estate investment trusts. If you want to avoid the sector entirely, consider **WisdomTree Dividend ex-Financials** (DTN, \$50, 4%). Most dividend-oriented ETFs are now heavily invested in telecommunications stocks, utilities and consumer staples.

Many foreign companies are stepping up payouts. A diversified, large-company international dividend fund can help mitigate currency and political risks. Consider **iShares Dow Jones International Select Dividend Index** (IDV, \$31, 5.8%), **PowerShares International Dividend Achievers** (PID, \$15, 3.7%) or **WisdomTree International LargeCap Dividend** (DOL, \$41, 3.2%). **K**

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