Insights Article

INTEGRITY VIKING FUNDS

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The Power of Five:
How to Use Dividend-Paying Stocks
to Create a Strong and Growing Retirement Income

Americans are living longer than ever before. That means retirement nest eggs need to last longer than ever before—and generate a steadily-growing income to keep pace with the rising cost of living throughout their retirement years—and to be sustainable in both bull and bear markets.

This is precisely why dividend-paying stocks should be considered as a core component of a retirement portfolio.

The Power to Create Your Personal Pension Plan

How can investors create their own growing income stream for retirement?

Imagine a hypothetical investment—say, a lump sum or a 401(k) rollover of $100,000, with a 3.5% annual dividend that consistently increases by 5% every year. In this example (see table below) dividends are reinvested and share prices remain the same.

In the first year, an investor would have income of $3,500. But the real work happens in the gradual but steady increase in dividends that well-run, established companies are able to generate over the long-term.

- At a 5% growth rate, annual dividend income would more than double every nine years.
- In year 10, dividend income is $7,921.
- In year 20, dividend income is $24,972.
- After 20 years, total dividends alone would generate a return on original investment of just under 25 percent.

Note that, in this illustration, the income continues regardless of the direction of stock prices. Perhaps more importantly, dividend payments continue to grow even if stock prices fall.

The Power of Five

A $100,000 investment, assuming reinvestment, would have hypothetically grown to more than $307,000 in 20 years—and produced total dividend income of more than $207,000 with a simple 5% annual dividend increase per share—even if the market did not appreciate.

Year	Investment	Share Price	DPS	Reinvested Shares	Shares	Yield on Initial Investment	Annual Income	Value
	$100,000.00	**$10.00**		0.00	10,000.00		-	
1		$10.00	0.35	350.00	10,350.00	3.50%	$3,500.00	$103,500.00
2		$10.00	0.3675	380.36	10,730.36	3.80%	$3,803.63	$107,303.63
3		$10.00	0.385875	414.06	11,144.42	4.14%	$4,140.58	$111,444.20
4		$10.00	0.40516875	451.54	11,595.96	4.52%	$4,515.37	$115,959.57
5		**$10.00**	**0.425427188**	**493.32**	**12,089.28**	**4.93%**	**$4,933.24**	**$120,892.81**
6		$10.00	0.446698547	540.03	12,629.31	5.40%	$5,400.26	$126,293.07
7		$10.00	0.469033474	592.36	13,221.66	5.92%	$5,923.57	$132,216.64
8		$10.00	0.492485148	651.15	13,872.81	6.51%	$6,511.47	$138,728.12
9		$10.00	0.517109405	717.38	14,590.19	7.17%	$7,173.76	$145,901.88
10		**$10.00**	**0.542964876**	**792.20**	**15,382.38**	**7.92%**	**$7,921.96**	**$153,823.84**
11		$10.00	0.570113119	876.97	16,259.35	8.77%	$8,769.70	$162,593.54
12		$10.00	0.598618775	973.32	17,232.67	9.73%	$9,733.15	$172,326.69
13		$10.00	0.628549714	1083.16	18,315.83	10.83%	$10,831.59	$183,158.28
14		$10.00	0.6599772	1208.80	19,524.63	12.09%	$12,088.03	$195,246.31
15		**$10.00**	**0.69297606**	**1353.01**	**20,877.64**	**13.53%**	**$13,530.10**	**$208,776.41**
16		$10.00	0.727624863	1519.11	22,396.75	15.19%	$15,191.09	$223,967.50
17		$10.00	0.764006106	1711.13	24,107.88	17.11%	$17,111.25	$241,078.75
18		$10.00	0.802206411	1933.95	26,041.82	19.34%	$19,339.49	$260,418.25
19		$10.00	0.842316732	2193.55	28,235.37	21.94%	$21,935.46	$282,353.71
20		**$10.00**	**0.884432568**	**2497.23**	**30,732.60**	**24.97%**	**$24,972.28**	**$307,325.99**

Retirement portfolios should concentrate on stocks with a long track record of steadily increasing dividend payouts each year, and the earnings capacity to sustain that track record. The increasing dividend is a key component in generating an increasing income that persists even when stocks are down, and even during times of economic recession.

The Power to Create Income in Down Markets

Many times, investors and the financial media seem to forget a key concept in dividend investing: actual cash income from dividends doesn't fall just because stocks fall.

Cash dividend payouts are an independent variable from stock prices.

As of this writing in 2019, there were 57 companies within the S&P 500 Index that have increased their dividends every year for the last 25 years in a row, according to Standard & Poor's.

These companies increased their cash payouts during the worst of the collapse of the Internet bubble in 2000, the stock market crash and Great Recession of 2008-2010, and the stock market correction and increase in volatility that occurred at the end of 2018. Even throughout the most severe market down turn and economic turmoil since the Great Depression, companies with a track record of increasing dividend payments continued to generate greater and greater income per share for their investors.

The Power to Beat Inflation

The object of a retirement plan must be to create a portfolio that will provide for a reliable retirement income for 20-to-35 years of retirement and even longer.

This income has to increase net of inflation—and minimize or eliminate the need to sell shares during down markets. With an adequate time horizon, a focus on stocks that consistently generate an increasing cash dividend payout in all market conditions has historically accomplished this objective.

Stocks that steadily increase their dividend payouts are also a natural hedge against inflation. They produce a liquid, cash income that increases every year by well in excess of the average historic inflation rate.

The historic U.S. inflation rate can vary quite a bit based on the time period you choose. Over the last decade, the average year-over-year inflation rate has been 1.52% But this excludes the high-inflation 1970s, which could potentially return again. Since World War Two, the average overall U.S. inflation rate, year-over-year, has been 3.22%, as measured by the U.S. Consumer Price Index.

Under both scenarios, U.S. dividend-paying stocks have a long track record of outpacing the inflation in dividend income generation alone.

The Power to Beat Bonds

Because income from stock dividends tends to increase over time, over long holding periods, stocks tend to have a natural advantage over bonds when it comes to generating retirement income.

Income from a bond or fixed-income investment, with the exception of a few specialized securities like TIPS, is just that: fixed. Income will not increase to counter the effects of inflation. As long as investors hold the bond, the coupon rate is what they will get, regardless of any increase in the cost of living or the growth of the economy. And if interest rates fall and you have to reinvest, interest income could actually fall.

Dividend income, however, is not directly tied to interest rate risk. It's more closely tied to the underlying fundamentals of the company.

The Power to Reduce Risk

While dividend income is a primary consideration for long-term retirement portfolios, it is naturally only part of the story. Across the board, dividend-paying companies have a long track record of generating better returns than non-dividend companies – at considerably lower risk.

A recent study published in the *Financial Analysts Journal* concluded: "Focusing on dividend-paying stocks significantly reduces risk, independent of investment style. This finding is true for value and growth portfolios as well as small-, mid-, and large- cap portfolios. This risk reduction is also largely present when combining value/growth and size styles."[i] (Source: Conover, Mitchell, et. al., *Financial Analysts Journal*, Vol. 72, No. 6. "What Difference Do Dividends Make?" November/December 2016. P. 28.)

This dividend advantage in volatile markets is a crucial concept in retirement planning: The steady and increasing cash dividends, coupled with lower downside risk in bear markets minimizes the potential need to sell shares in a bear market to meet living expenses. Without the cushion of years of increasing dividends, an investor in non-dividend paying stocks or fixed income investments may need to sell securities in order to meet current income needs, because the current dividend or interest payout is not sufficient. Selling shares because dividends aren't sufficient leads to a permanent pay cut.

A Note About the Numbers

Is a 5% annually increasing dividend a realistic expectation? Yes. Many dividend-paying U.S. companies have a long track record of increasing dividend payments for 20, 30, 40 and 50 consecutive years. From 1990 through the end of 2018, the average, or mean annual dividend growth rate for the S&P 500 index as a whole has been 5.98% through December 31, 2018.

The performance table shown is strictly a hypothetical illustration of mathematical principles and does not predict or project the performance of an investment or investment strategy. It is not intended as investment advice. Data is used for illustrative purposes. No investment can guarantee principal value, dividends, or the growth of dividends. Investments may lose value. This illustration does not consider taxes. Please consult your financial advisor for more information.

About Integrity Viking: The Niche Fund Group

Integrity Viking Funds, founded in 1987, is a boutique asset manager with a focus on income producing strategies. Integrity Viking Funds manages assets for individual investors, registered investment advisors and broker/dealers. The Fund is available at more than 500 financial intermediaries in the U.S.

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