Dividend Season Scorecard

November 21, 2013

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As consumers gear up for the upcoming holiday shopping season, many investors in individual equities are eagerly anticipating another season that, instead of draining their wallets, might actually fatten them—dividend season. Don Taylor, portfolio manager of Franklin Rising Dividends Fund, is on the lookout for companies which not only have a track record of paying regular dividends, but increasing them. Here are some of Taylor's thoughts on the early dividend season scorecard.

Dividends, often drawn from earnings, are one way in which profitable companies may choose to pay back investors. They are typically cash payments made on a regular basis, such as quarterly or annually. I define the "dividend season" as essentially a six-month period often starting in November and running through April. We have found that a number of companies tend to increase their dividend right before, or right after calendar year-end, and then another group will do so around the time of their annual meetings.

Based on historical patterns, it appears to us that more than two-thirds of the companies in our portfolio could increase their dividend in the next six months. A few companies in our portfolio already announced dividend increases in October. Honeywell and United Technologies both had 10% dividend increases[1] and Abbott Laboratories had a 57% dividend increase[2], which was a very big surprise. I doubt we will see many (if any) other dividend increases of that magnitude this season, but of course, it's a welcome sign. We always look for companies that have the potential to post double-digit increases in their dividend. On average this season, dividend growth rates for the companies we track look to be in line with the healthy dividend growth rates we saw in the comparable period a year ago.

The US equity market overall has had a strong performance this year, with the S&P 500 up more than 20% through November 12.[3] It has been a favorable environment for US stocks: moderate economic growth with very little inflation. This enables earnings to grow and monetary policy makers to maintain an accommodative bias. I feel good about the long-term prospects for US equities, but even if we see a market correction, I would relish the opportunity to buy on weakness. Through 2013 to date, there really hasn't been a significant market drawdown.

An Expanding Dividend Pool

More companies that traditionally have not paid dividends are doing so today, which widens our investment pool. In the late 1990s into 2000, particularly in the technology world, the notion of paying a dividend was really not accepted, or at least not widespread. Going back 10-12 years, very few tech companies met our Franklin Rising Dividends Fund screens. In the aftermath of the bursting of the tech bubble around that time, a lot of technology companies became more interested in a dividend-oriented strategy, so they begrudgingly adopted dividends as part of a capital allocation strategy. It's at a point now where there are several good-sized technology companies that have a record of rising dividends and that meet our investment criteria. One of the first big technology companies to initiate a dividend policy, IBM,[4] has been in our portfolio for several years. More recently, we added Qualcomm.[5]

Over time we are likely to see more and more companies, including technology companies, with a record of rising dividends. Some of them will meet our screens, some of them won't, and some of them could be in a position to qualify further down the road. So, with a longer-term horizon in mind, I would suspect we could see greater emphasis on technology companies in our portfolio.

The Screening Process

We employ a unique, disciplined approach to stock selection, and not all companies, even those with a history of dividend payouts, will meet our screens. Companies must meet the following criteria before stocks are considered for purchase:

- **Consistent Dividend Increases.** We only consider companies that have increased their dividend in at least eight out the last 10 years, without a decrease.
- **Substantial Dividend Increases**. We look for companies that have doubled their dividend over the last 10 years.
- **Strong Balance Sheets.** We invest in companies with strong financials and low levels of long-term debt.
- **Reinvested Earnings for Future Long-Term Growth**. We search for companies that reinvest at least 35% of their earnings in their own future growth.
- **Attractive Price**. We purchase shares that are attractively priced relative to historical valuations, and stocks must have a price-to-earnings ratio (P/E) in the lower half of its range over the last 10 years or less than the current P/E ratio of stocks in the S&P 500 Index.

An example of a company in our portfolio that meets all our screens is Becton Dickinson,[6] which is a company we think could see a dividend increase in November. We first bought Becton Dickinson about 17 years ago, and it's increased the dividend every year since then. For companies to offer significant dividend growth potential, they have to have good, steady, consistent growth both in their gross revenues and their net earnings per share; the cash flow in dividends comes along with that.
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What Are the Risks?
All investments involve risks, including possible loss of principal. Value securities may not increase in price as anticipated or may decline further in value. While smaller and midsize companies may offer substantial opportunities for capital growth, they also involve heightened risks and should be considered speculative. Historically, smaller- and midsize- company securities have been more volatile in price than larger company securities, especially over the short term. These and other risks are detailed in the prospectus.

Companies in the technology sector may be affected by worldwide technological developments, the success of their products and services (which may be outdated quickly), anticipated products or services that are delayed or cancelled, and investor perception of the company and/or its products or services.

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1. As of 9/30/13, Honeywell International Inc. common stock represented 2.31% of net assets of Franklin Rising Dividends Fund. As of 9/30/13 United Technologies Corp. represented 3.15% of net assets of Franklin Rising Dividends Fund. Holdings subject to change without notice.

2 As of 9/30/13, Abbott Laboratories common stock represented 0.88% of net assets of Franklin Rising Dividends Fund. Holdings subject to change without notice.

3. Source: S&P Index Data Services. Copyright © 2013, S&P Dow Jones Indices LLC. All rights reserved. Reproduction of the S&P Index Data Services in any form is prohibited except with the prior written permission of S&P. S&P does not guarantee the accuracy, adequacy, completeness or availability of any information and is not responsible for any errors or omissions, regardless of the cause or for the results obtained from the use of such information. S&P DISCLAIMS ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE. In no event shall S&P be liable for any direct, indirect, special or consequential damages, costs, expenses, legal fees, or losses (including lost income or lost profit and opportunity costs) in connection with subscriber's or others' use of the S&P Index Data Services. Indexes are unmanaged, and one cannot directly invest in an index. Past performance is not indicative of future results.

4. As of 9/30/13, International Business Machines Corp. common stock represented 3.17% of net assets of Franklin Rising Dividends Fund. Holdings subject to change without notice.

5. As of 9/30/13, Qualcomm Inc. common stock represented 2.43% of net assets of Franklin Rising Dividends Fund. Holdings subject to change without notice.

6. As of 9/30/13, Becton Dickinson & Co common stock represented 2.41% of net assets of Franklin Rising Dividends Fund. Holdings subject to change without notice.