Play Safe, Use the Dividend Yield Strategy to Identify Best Stocks

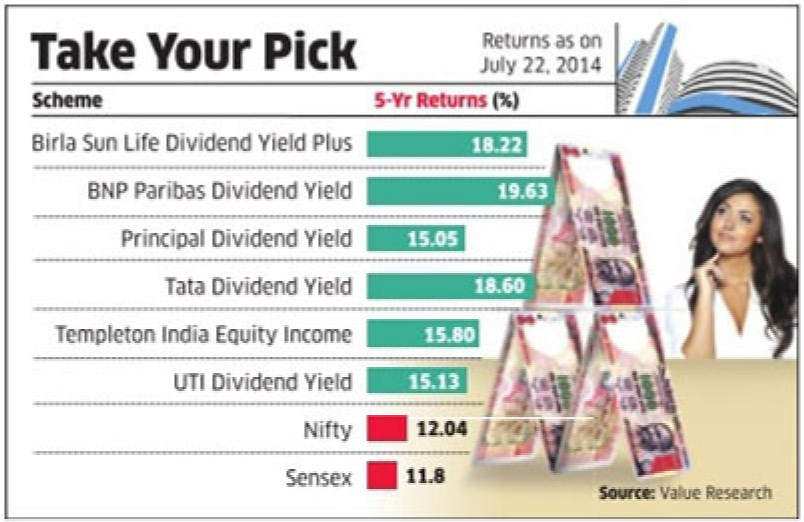
Experts advise investors to build a portfolio around the dividend yield theme instead of betting on one or two stocks and remain invested for at least two to three years, says Nikhil Walavalkar

Is it time to play it safe in the stock market and employ dividend payout strategy to pick stocks? Many investment experts feel so. "We have seen a good rally in the equity markets, and there may not be much upside in the broad markets. Investors with a medium- to long-term view have to stick to fundamentally strong companies," says Kunj Bansal, chief investment officer, Centrum India. He recommends applying the dividend yield strategy as it is a relatively safer approach to pick stocks.

Dividend yield is calculated by dividing dividend per share by the price of the scrip. Companies with consistent dividend payouts are seen as fundamentally strong bets in equity markets. Vikas Gupta, EVP — traded markets and investment research, Arthveda Fund Management says, "Investors should look at large-sized companies offering dividend yield in the range of 3-4%, which will help them steer clear of junk in the stock market."

Dividend payout is an important factor that investors should not ignore. In FY2013-2014, these payouts rose to 30.8% of net profits from 23.2% of net profits five years ago. Increased dividends surely add to returns. They also offer some downside protection in a volatile market, say experts.

"Dividend yield can be a good yardstick, in addition to other factors, to assess shares of a company for investment," says Pankaj Pandey, head — research, ICICIdirect.com.



In FY14, dividend payouts rose to 30.8% of net profits from 23.2% of net profits five years ago

Companies expected to report good growth and available at attractive dividend yields are good portfolio candidates. Pandey recommends Coal India and NMDC as they may benefit from growth in volumes and better pricing for their mining output. Attractive yield at which these stocks quote, make them a good long-term investment buy, he says.

Play it Safe

However, experts also ask investors not to give too much weightage to the rise in overall dividend payouts by companies. "Dividend payouts have not gone up in all sectors. While companies in FMCG and IT have increased dividends, cyclical companies have reduced dividends," says Bansal. Investors should also be wary of higher dividend yield, especially above 6%, says Gupta. "These can be cases of special dividends or some junk stock," he says.

Many a time, companies receive windfall gains by way of sale of assets, settlement of court cases or though some other route and they share it with shareholders by declaring a huge dividend. Cash-rich companies may also declare a special dividend. This spikes dividend yield of the stock. Gupta recommends investing in quality stocks offering good dividend yield, such as Balmer Lawrie Investments, Coal India and Oil India. One can also look at quality mid-cap stocks that can benefit from the high growth and liberal dividend payouts in future, say experts. Bansal recommends investing in PI Industries and Divis Laboratories among mid-sized companies.

Experts suggest building a portfolio of stocks around the dividend yield theme instead of betting on one or two stocks. If you find this difficult, you can look at mutual fund schemes. There are eight such schemes that build their portfolios on the basis of dividend yield and have a long-term track record. They have beaten the broad equity markets, represented by CNX Nifty, over past five years. Though dividend yield strategy looks good for investors, investors must be focused on the long term, say experts. "The strategy will reward you if you remain invested with a two- to three-year view," says Pandey. If you are looking to cash in on the momentum, it does not suit you.

nikhil.walavalkar@timesgroup.com