Letter to the Editor

May 22, 2012

The following is in response to Richard Skagg's article, [Dividends: A Timeless Component of Equity Return], which appeared on May 15:

To the Editor:

I take issue with the author's characterization of the historical importance of dividends:

> Hypothetically, a $100 investment made at the end of 1929 would have become $6,566 by the end of March 2012 based on price change alone. However, when adding the compounding effect of dividends, the same hypothetical $100 investment would have become $162,925. The equity value is 24.8 times greater at the end of the period because of the yield component. Examining a more recent time frame, from the end of 1979 through the end of March 2012, the S&P 500 with reinvested dividends turned $100 into $3,145, compared to only $1,305 from price change alone. Over the long term, dividends have a meaningful impact on total return.

This analysis was used by Jeremy Siegel in his book, *The Future for Investors* (page 126), and repeated ever since. But the conclusions are not correct. The graph Siegel used looks essentially like the one below (using nominal returns instead of Siegel's real returns). It charts the value of a portfolio that reinvests all profits on the top line. The lower line measures the value of a portfolio *that has had its dividends removed* as they are earned:

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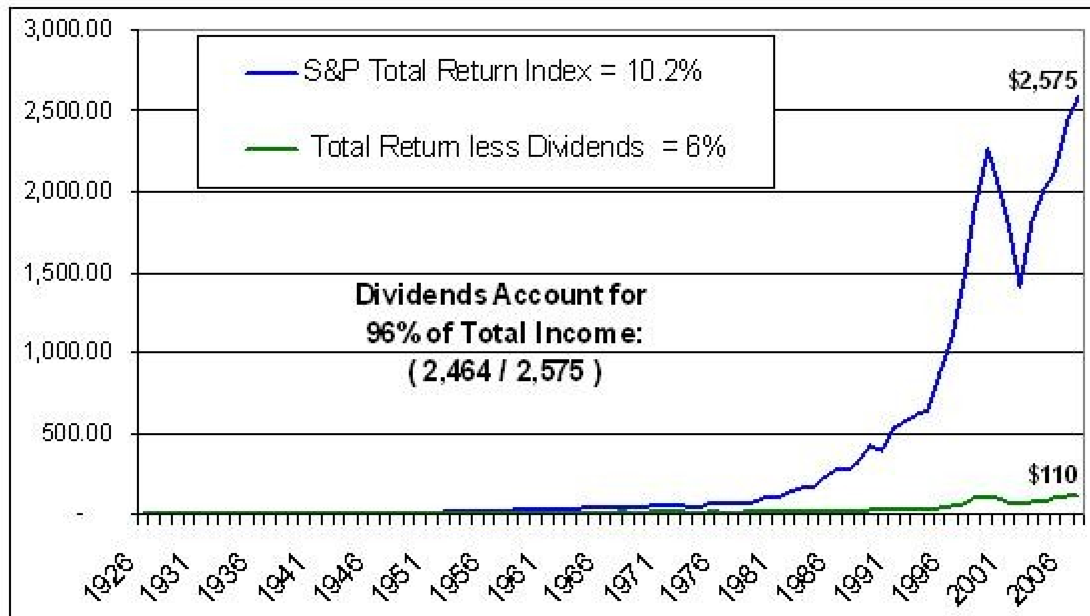
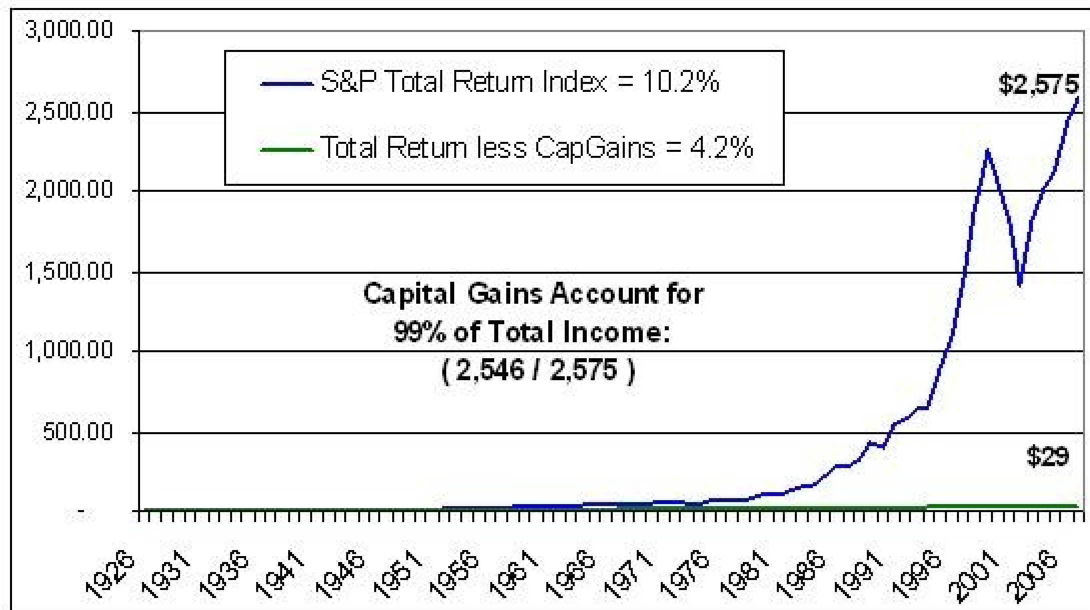


Using the exact same data, assumptions and methodology, a similar chart can be prepared to compare the same total return portfolio (on the top line) to the lower line measuring the value of a portfolio *that has had its capital gains removed* at each year end.



They are essentially the same. You cannot conclude, as the author did, from the first graph that the *"equity value is 23.4 times greater at the end of the period because of the*

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yield component" because the second graph would prove the opposite – that "the *equity value is 88.8 times greater at the end of the period because of the capital gains component*."

The reality is that these graphs do not show anything at all about either the importance of dividends or capital gains. They show only the importance of reinvesting your profits if you want your wealth to grow.

The explanation of why these charts end up looking the same, and the spreadsheet with all the figures is available at Retail Investor .Org.

Thank you,

Don Right
Burnaby, Canada

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