

# Seeking Alpha $\alpha$

## Intel, Verizon, AT&T Among the Lead 'Dogs of the Dow'

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"The perfect investment strategy stops working the moment you start following it." So said [Harry Browne](#), a former investment newsletter editor who was the Libertarian Party's candidate for president in 1996. In fact, I'm sure many of you will agree that he couldn't be more right. Swapping investment strategies is not like swapping rookie baseball cards. It gets very personal. I have first person accounts of how offended some readers get at the mere mention that there may be another way to trade that is worthy of consideration.

I wrote an [article](#) recently where I highlighted Sirius XM's ([SIRI](#)) well-known stock pattern leading into earnings. Arguments were made from both sides (bulls and bears) over why my strategy would not work. But regardless of how one feels about an observation, I think we can all agree that the most important part of any investment strategy is one that aligns with the individual's goals and is monitored closely by the investor.

### The Dogs of the Dow

In 1991, [Michael O'Higgins](#) devised an investment strategy called "[the dogs of the Dow](#)," which proposes that an investor annually select for investment the 10 Dow Jones Industrial Average stocks whose dividend is the highest fraction of their price. Those who support the strategy contend that companies of "blue chip" status very seldom adjust their dividend to reflect current trading conditions. Therefore, the dividend is a measure of the average worth of the company. The stock price, in contrast, fluctuates through the business cycle.

If you can appreciate the logic in this strategy, then you can also agree that it means that companies with a high yield, with high dividend relative to price, are near the bottom of their business cycles and are likely to see their stock price increase faster than low-yield companies. It stands to reason that investors who base their decisions on this model and annually re-invest in high yield companies should outperform the overall market. The logic behind this is that a high dividend yield suggests both that the stock is oversold, and that management believes in its company's prospects and is willing to back that up by paying out a relatively high dividend.

Investors are thereby hoping to benefit from both above average stock price gains as well as a relatively high quarterly dividend. Of course, several assumptions are made in this argument. The first assumption is that the dividend price reflects the company size rather than the company business model. The second is that companies have a natural, repeating cycle in which good performances are predicted by bad ones.

So, on the 20<sup>th</sup> anniversary of O'Higgins' investment strategy, I want to revisit the concept, as well as investigate how some dogs of the past have performed over the years and where future dogs may be headed. The playbook advises investors to buy on January 1 the top 10 stocks that offer the best dividend yields and are replaced 52 weeks later with the highest indicated yields at the time.

### 2010's Top Dogs

Several surprising names surfaced when trying to identify the top dogs of 2010, or the best dividend-yielding stocks. The first name on the list was **Dupont** ([DD](#)). The senior member of the Dow, a mainstay on the index for over 75 years, traded last year with a dividend yield of almost 5%. The stock rose close to 30% or about 10 percentage points better than the DJIA at the time of record.

**Kraft Foods (KFT)** was only added to the Dow in September 2009. Since then, it has neither gained nor lost ground in these last 12 months. The stock yielded 4.2% and has a market cap of nearly \$55 billion. One of the best companies in the entire world, Kraft manufactures and sells a great variety of packaged food products. The stock currently sits only percentage points away from its 52-week high.

The company that loves to see you smile, **McDonald's (MCD)** also comes in as a top dog. The stock had a flat performance over the last year. But its shares currently yield 3.3%. In the last five years, **McDonald's** has grown its earnings per share (EPS) at an extraordinary rate of 26% per year, outperforming the sector by 18% and the S&P average by over 22%.

**Merck (MCK)**, a Dow member since 1979, also makes the list. The pharmaceutical giant has a market cap in excess of \$102 billion and sports a dividend yield of 4%. Merck stock outperformed the Dow by about 5%.

Telecom giant **Verizon (VZ)** also makes the list. Not only does it sport the nation's largest and arguably best wireless network, but it also pleases shareholders by offering investors a better than 5.5% annual payout.

### Current Top Dogs of 2011

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Symbol	Company	Price	Yield	Small Dog
NYSE / NASDAQ	The Dow stocks	on 4/5/11	on 4/5/11	on 4/5/11
<a href="#">T</a>	AT&T	30.7	5.60%	Yes
<a href="#">VZ</a>	Verizon	38.38	5.08%	No
<a href="#">MRK</a>	Merck	33.16	4.58%	Yes
<a href="#">PFE</a>	Pfizer	20.45	3.91%	Yes
<a href="#">KFT</a>	Kraft	31.49	3.68%	Yes
<a href="#">INTC</a>	Intel	19.71	3.65%	Yes
<a href="#">JNJ</a>	Johnson & Johnson	59.8	3.61%	No
<a href="#">MCD</a>	McDonald's	76.6	3.19%	No
<a href="#">PG</a>	Procter & Gamble	61.67	3.13%	No
<a href="#">DD</a>	DuPont	56.06	2.93%	No

You can see there are some prominent companies on this list, with AT&T ([T](#)) leading the way with a dividend yield as high as almost 6%. It's not surprising that there are some familiar names that are mentioned that also appeared on the list for 2010. Verizon, Merck, McDonald's, and Dupont have become "divas of the dividends."

Intel ([INTC](#)) is worth mentioning here. A rebalancing of the Nasdaq 100 which takes effect on May 2 was announced yesterday, and INTC was one of three stocks mentioned as having had its weightings increased. This should bode well in the near term for the stock.

### Summary

The dividend component is just one aspect of the strategy; which has beaten the Dow by about three percentage points a year (on average over the last 50 years). Though it presents somewhat higher risk, the concept has proven to be extremely successful. Having said that, it is worth noting that this investment strategy hasn't fared particularly well over the past two years due (in large part) to the slowed economic recovery. Going back to Browne's quote, I can only say, there is no such thing as a perfect investment strategy. But the path towards perfection starts with having one.

**Disclosure:** I am long INTC.