Kimura Dreamvisor Newsletter Summary 17th October 2006

High-income shares investment key points.

Psychological background is risk taking avoidance.

I am often questioned about the best way to invest in high income stocks My core investment strategy is value based, I use equally dividend yield, Per and Pbr, cash flow ratios but as a whole I do not invest on the sole basis of dividend yield. A high dividend yield is positive but quickly well publicized therefore dividend yield just cannot move a stock by itself. Rather I believe that prospective dividend increase and dividend recovery have greater impact on stock price, I feel that low dividend payout ratio stocks and 0 dividend stocks are in fact more interesting.

Best timing to focus on high income stocks is usually only 3 to 9 months before earnings announcement meanwhile investors who bought in anticipation already aim at profit taking and adequate investment timing is often too late.
These set aside high-income stocks usually focus investor's attention either when stocks become unpopular or are overbought, which is negative.

Stock purchase initial motivation is profit distribution, stock price goes up in anticipation of future profit increase, should this prospect turn negative then stocks are sold. In addition whether earnings are paid out to shareholders (dividends) or set as reserve for future expansion investment profitability remain unchanged (dividend and capital gain tax are equal). Consequently I find bizarre the theory stating that stock price (ex dividend) is impacted by dividend policy. Theoretical stock price level is not dictated by dividend but by earnings. Consequently I believe Per is far more important than dividend yield for investment standard.

Investing in equities carries the prospect of stronger than market anticipated earnings growth. For this I believe that only specific psychological background supports high dividend equities focused investments. Said in other words there is interest to buy equities but excluding risk taking associated with it! After long bear market investors tend to emphasise loss potential limitation rather than high rebound expectations. If dividend yield compares nicely to bond yield potential damages are limited. In this particular case dividend yield becomes a supportive factor one can trust.
Above that when equities are highly valued dividend yield is sometime used to cover the downside risk. Specially when both stocks and rates are high then high income stocks, like utilities, provide a comparatively secure investment. In all cases the required stance is not to chase aggressively profit but make money on the long haul.

Buying targeted at dividend cashing is usually done at fiscal year's end.

To trade in equities targeting roughly 1 - 2 % dividend by fiscal year's end is not really high level action in terms of investment strategy, target can be increased to 10 % although it is unwise to make it too foolish. When I personally buy stocks targeting end of fiscal year's dividends I start at least three months in advance and as a general rule buy at lows. The most appropriate selling strategy is to wait the last payment rights day or just 2 3 days in advance.

By securing 5 % profit on a three months basis you can make 21 % gross return on a year basis, if securing 10 % profit you can achieve 46 % gross return on a year basis.

The average individual investors usually act on the sole basis of specialized newspapers and magazines that is roughly 2 month delays compared to the professional investor (I include myself). ‘Beggar who panics says that getting is few’: any strategy solely targeting dividend cashing at fiscal year’s end is insufficient to analyse properly stock price level and earnings downside revision risk

You may call it somewhat ‘grand tactics’ but there is great value in chasing stocks with both low Per and low dividend yield ratio (low dividend payout ratio). When earnings trend goes up and because the payout ratio falls further, then when earnings upward revision materializes progressively dividend will increase. Such stocks universe is quite important.

Honda or Toyota related parts makers stocks were very representative of the above mentioned universe, should you have bought on weakness the rewarding probability was very high. Toyota fiscal year 2003 dividend was 45 Yen, it is now 100 Yen. Canon also increased dividend from 50 Yen to 100 Yen (before repartition). I believe this should also extend to trading companies and Steels despite some uncertainties on earnings. This said stock holding in itself is not aimless and it is always advisable to sell when a peak has been reached.

Speaking about dividend chasing utilities stocks must hits on investors mind, however I not believe (9503) Tokyo electric Power is currently suitable. The stock quotes 3,500 Yen at 12 years high, dividend yield is 1,71 % with 60 Yen dividend and Per is 19x. Long-term rates rose to 1,8 % recently, relative attraction has gone down. Probably there are some players buying utilities as defensive play against economy slowdown selling cyclicals.

Nevertheless if you are considering dividend cashing strategy you are well advised to select the mid caps universe or new growth listed equities rather than overbought large caps universe. Check out mid term earnings and then seriously have a look at the December Shikiho edition (Japan companies handbook winter edition when published).