



Yield Chaser

By CK Wong 2007.08.04

<http://www.ck-wong.ca/Money%20Matters/yield%20chas3er%20200804.pdf>

Introduction

Yield chaser is a term usual considered as a non-aggressive investment style because it is a very layback and passive approach. My recent study provides some interesting observations that say other way.

Yield for Security

I see yield as the payout in monetary form by any investment vehicle. If the vehicle provides interest, it is the ratio of the interest to the principle. If the vehicle is share it is the dividend amount to the security's purchase price. Please note that I adopt the definition of bond trading because the yield should tie to the purchasing price rather than its nominal rate.

The nature of the yield is a very steady and slow changed. In the case of bond the profit comes from the variation of the bond price (no the par value) and the base is small so it is very exciting. In this article I am limiting my ignorant to the domain of security. Bond is too complicated.

I have been a yield chaser other than the reason of lazy but also for the need to have income. The earnest desire for income forces me to jumping horse to horse. In a high speed horse race, jumping horse is definitely a dangerous act at best if not lethal. During the process the stock exchange and the broker have been the big winners.

But I am not alone. Yield chaser has been practice by the most vulnerable group of investors, i.e. the retail investor with very limited knowledge of investment and access to research. They buy good dividend stock with good reputation and hope the dividend can support their life. In the most recent days, the most widely held BCE stock by Canadian was privatized. This creates a severe panic among these vulnerable investors. The current widespread snake oil type of investment advise practice, these investors may very possibly got their money thrown into some highly glorified and over priced investment. What could be the next step?

Strategy

My search is simple. I would like to identify a stock that provides me steady income and preferably preserve by wealth. This creates the following requirements:

1. Strong company performance which has a steady good return of equity and capital.
2. Wide market moat which avoid any erosion of sales and profit.
3. Good margin that provide good and steady payout.

4. Good management that does not jump on *short term gain long term lost strategy*. Good management that fences off take over of the company to avoid the loss of investor's income.
5. Good social ethic to avoid any law suit down the road.

These seem motherhood statements but not too many one could fit the bill. Tobacco companies fit the bill in the past but their market is shrinking and the damaging health liability certainly not a good reason to sleep through the night. So let's deduce the consequent of practicing the strategy above.

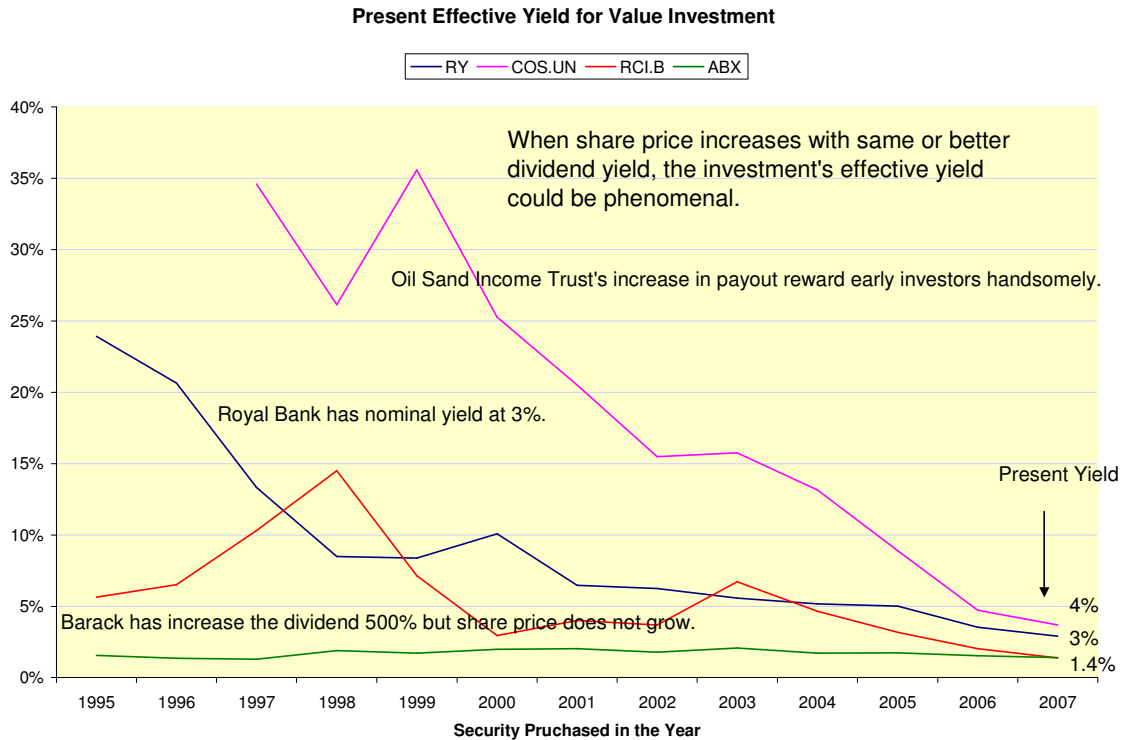
1. The company's top line should be a steady growth rather than quantum leap with one time deal, one time tax refund or sales.
2. The company must continuously evolve with the market to anticipate the future need through a strong R&D department which does not have to be huge and insinuated the profit. The check and balance of these R&D must be reasonable and adventurous to add the width of the moat.
3. Tell tale signs for good company usually satisfy all the following criteria:
 - a. Low debt ratio or continuous reduction of debt ratio.
 - b. Continuous reduction of cost through ingenuity, technology, organization effectiveness and the most important the training of the staffs.
 - c. Good benefit to the working level but not exuberate. The compensation of the senior should be transparent and directly linked to the company performance.
 - d. Reasonable growth on outstanding shares without reducing the book value of the company to protect the existing share holder.
 - e. Senior executives own a good portion of the company and do not trade often.
 - f. Continuous increase in process of increasing the share value such as through share buy back or unloading non-core business.
 - g. A trend and history of increasing paying out dividend.
 - h. A trend and history of share price appreciation.

Value or Growth?

From the criteria above, it has shown a combination of value (dividend) and growth (price appreciation) investment style. Perhaps we should not be bog down by the label of value or growth style but pick the best of both. If you ask the question would such stock exist? Then my answer would be this is why we need to do the homework and do not mislead by the financial advisor to pull you through the eye of a needle. It is just too dangerous to have blind trust to any one nowadays.

Case Study

The following are some examples which I prepare for this discussion and do not mean to be stock recommendation. The reader should work with their financial experts to mitigate every investment opportunity.



In this illustration, Canadian Oil Sand Income Trust was paying C\$0.40 per year dividend at a share price about C\$45 in 2004 which is about 0.9%. This could not be possibly a value investment. However if you invest in 1997 at \$17, this will give you the yield of 2.4% which close to the bank’s nominal dividend yield. If you keep your investment from 1997, after the 5:1 split in 2006, your effective rate of your 1997 investment become 34.6% which is better than any income trust or GIC.

However, if you do not pick the stock that appreciates the price thorough the year, like Barack, although they have increase their dividend 500% it still remains at a much lower yield at 1.4%.

Canadian Oil Sand and Barack are very risky business. One could argue that you are luck to bet on them. Let’s turn to some wholesome good old Canadian bank that nobody can deny. The old sleeping stock turns out to be very exciting.

First, in 1995 the share price was about C\$27.75 and has about 3% yield. Since than there were two split which makes your adjust cost base to be C\$6.69. With the C\$1.60 annual dividend, your investment has a dividend yield almost 24%.

Resources

[1] <http://finance.yahoo.com/>