Dividend Drop-Off: When Cushions Turn to Rocks

By The Mogambo Guru

03/09/09 I thought that my eyes were playing tricks on me, but it looked like the earnings of the S&P Industrials Index went down last week, plummeting to $65.86 from $85.90 the week before, all of which probably explains why the Wall Street Journal reports that railroads "have seen shipping volumes drop by double-digit percentages in recent months", and that "the nation's five largest railroads have put more than 30% of their boxcars – 206,000 in all – into storage." Yikes! A third less volume!

In a similar vein, Giovannie Bisignani, director general of the International Air Transport Association, says that volumes of air cargo traffic are in "free fall", dropping 29.5% from a year earlier, and 17% of it in December alone!

One of his associates quipped, "It's gone from terrible to unprecedented" which is clever and humorous, and thus the only bright spot in the whole mess, as far as I can tell.

Then Bloomberg.com notes that it's not just earnings that are falling, but dividends, too! They report "The fastest reduction in U.S. dividends since 1955 is depriving investors of the only thing that gave stocks an advantage over government bonds in the last century."

The explanation for this cryptic remark is provided by James Swanson, chief investment strategist at MFS Investment Management. He says that dividends are what matters, and "It's a greater fool theory if we always buy stocks based on earnings and we never get a penny out of it, hoping for someone to buy that stock at a higher price."

In fact, he says, "Dividends have been a cushion in bad times" and the Really Bad News (RBN) about this drop in dividends is that "If they go to zero, it's a disaster".

Now, as a bad husband, a worse father, a terrible neighbor and an incompetent employee, I obviously know a lot about "disasters", and trust me when I tell you that it's going to Cost You Plenty (CYP).

Bloomberg, taking no interest in my insightful observations gleaned from a lifetime of paying for my screw-ups, is still talking about dividends, and reports that "Twenty-six companies in the S&P 500 saved more than $21 billion by cutting or suspending outlays this year, more than all the reductions from 2003 to 2007. On a per-share basis, S&P 500 companies may trim payouts 13 percent this year, the biggest drop since 1942."

This big drop in dividends is plenty bad by itself, but the news is doubly bad because "saving more than $21 billion" means that a lot of companies got $21 billion less in revenue! Which doesn't even talk about the multiplier effect as that money cascades through the economy!

Econometrically, applying a mysterious “constant growth version of the so-called dividend discount model”, which “values a stock as the sum of all its future dividends,” the Really Bad News (RBN) is that it “shows equities are still overpriced. With S&P 500 companies projected to pay a combined $25.57 in dividends this year, the index would need to fall to 526.46 before investors are compensated for owning shares.”

This means another drop of 25% in the S&P 500 index, assuming that there are no more dividend cuts, and I would have to be an idiot to think that! Okay, I really AM an idiot, but I am still freaking out here!

This is not, as you could expect, a dire economic forecast based on the “velocity” multiplier-effect of a third less volume in transportation traffic, meaning a huge drop in transactions, which implies that less money is coursing through the economy, or about dividends being cut and stocks falling precipitously in price as a result, but about gold – glorious, wonderful gold – and how if you aren’t buying it, then there is something Very, Very Wrong (VVW) with you if you can look at this stuff, and look at economic history, and look at the Austrian school of economics which you can get free at Mises.org, look at the dismal economic situation of the world and then not buy gold. It amazes me!

And then I remember that “the majority of investors must lose money”, which means that the only reason I can make so much money with gold is that I am in the minority, who are the guys who make the money that the majority loses!

Whee! This investing stuff is easy!