



Brian H. Card – Financial Advisor

142 E. Main Street, Princeville, IL 61559
4924 W. American Prairie Drive, Peoria, IL 61615
309.385.4375



When Investing Pays Dividends

Typically, stocks that pay a portion of earnings to shareholders in the form of dividends are not considered to be superstars of the stock market. They typically do not offer the growth or price appreciation potential of small-cap companies, but tend to be more stable.

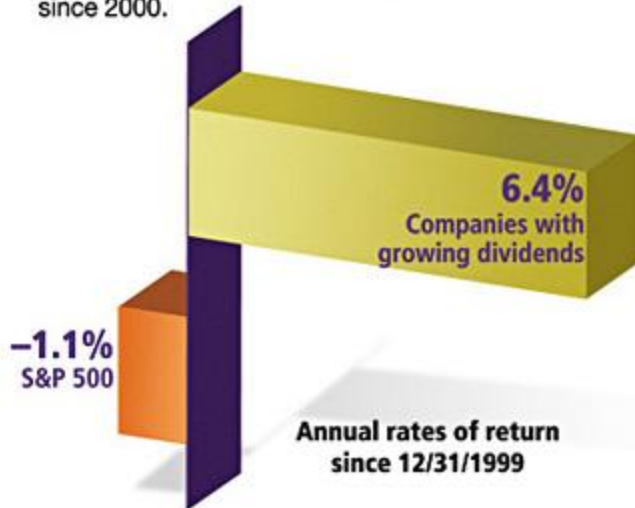
Dividends may not only help provide income but could also point the way toward possible investment opportunities. Aside from the potential for steady payments, dividends can be a good way to assess a company's health, quality of earnings, and future prospects. In fact, research shows that companies that have started or consistently increased dividend payouts since 1972 have outperformed the broader market.¹

Companies that pay dividends tend to be large and well established, and their stock may be appropriate in a conservatively allocated portfolio. Companies may elect to pay a dividend because they consider it to be a better option for distributing profits than reinvesting in the business.

Even though income stocks are theoretically less risky than growth stocks, the return and principal value of all stocks fluctuate with changes in market conditions. Shares, when sold, may be worth more or less than their original cost.

Payout and Performance

One key to income investing is finding companies that have consistently increased their dividends year after year. In fact, companies that have steadily increased their dividends for 25 years have outperformed the S&P 500 since 2000.



Source: *Money*, January/February 2010. The performance of an unmanaged index is not indicative of the performance of any particular investment. Individuals cannot invest directly in an index. Past performance is no guarantee of future results.

The Uncertainty of Taxes

Under current law, qualified dividends are taxed at a maximum rate of 15%. For taxpayers in the two lowest federal income tax brackets (10% and 15%), the tax rate on dividends is zero.

However, these low tax rates are set to expire on December 31, 2010, unless Congress acts to extend them. If the special tax treatment is allowed to expire, dividend income taxation will revert to the rules that were in effect prior to 2003. Under these rules, dividend income is taxed at the same rates as ordinary income, which could be as high as 39.6%.

The possibility of higher dividend tax rates in 2011 is a factor to consider when investing in dividend-paying stocks. It would be wise to consult with a tax professional before taking any specific action.

Income stocks can offer a steady payout as well as the possibility of solid returns.

1) CNNMoney, November 9, 2009

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