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Domestic dividend stocks disappoint


Keith Richards

Higher dividend paying stocks were the worst performers in 2015 when compared to low- or no-dividend paying stocks in Canada.

Witness the Bank of Montreal's Canadian market dividend ETF, the **BMO Canada Dividends ETF** (ZDV-TSX, $13.73).

After peaking in the late summer of 2014, this ETF has been in a defined downtrend.

The attractive current yield of around 4.8 per cent did little to offset the loss of more than 20 per cent since 2014's peak price.

This ETF was influenced by energy. Note its coinciding peak with energy. The index currently holds about 22 per cent in that sector, the balance being spread between financials, utilities and the like.

Obviously, energy's impact on other sectors in the economy, particularly the blue chips, had a correspondingly negative impact. My last article in *Investor's Digest* covered the economic impact to Canada of the energy sector.

Canadian growth stocks, which tend to be less dividend-oriented, experienced a 15 per cent drawdown since early 2015.

Growth stocks, as illustrated by the **iShares Canadian Growth Index ETF** (XCG-TSX, $26) have a 15 per cent exposure to the energy sector, with less focus on dividends in its holdings.

Further, that ETF has far less financial exposure, no utilities, and more exposure to industrials, consumer staples and discretionary stocks, and health care.

I am sure the 10 per cent exposure to **Valeant Pharmaceuticals International Inc.** (VRX-TSX, $121.67) and the 15 per cent exposure to our two railways, **Canadian National Railway Co.** (CNR-TSX, $72.90) and **Canadian Pacific Railway Ltd.** (CP-TSX, $150.55) had an overly negative impact on this ETF.

The broader TSX 300 was beaten down by more than 16 per cent from its early 2015 peak (only slightly lower than its late 2014 peak, so let's call that a wash), which was similar to the Canadian growth ETF.

Again, compared to the 22 per cent drawdown by the higher dividend-paying stocks–the TSX's drawdown was comparatively tame.

The U.S. dividend stocks didn't fare as poorly as our Canadian high dividend payers.

The **Vanguard High Dividend Yield ETF** (VYM-NYSE Arca, US$62.50) and **iShares Select Dividend ETF** (DVY-NYSE Arca, US$72.83) both hold blue chip stocks such as GE, Microsoft, and Johnson & Johnson as well as utilities (although more so in the case of DVY).

There's a much smaller emphasis on energy in those two ETFs than the Canadian ETF equivalents noted above.

Only 10 per cent of VYM's holdings, for example, is in energy. In fact, these ETFs performed pretty much in line with the broad markets, only down about three per cent from their peak price in early 2015.

The three per cent yield on these ETFs offset that minor loss to create a break-even year for investors who bought at the top.

It will be interesting to keep an eye on the chief sectors within the dividend ETFs' holdings. Students of technical analysis might be aware of "regression analysis" studies.

In essence, regression analysis suggests that markets and sectors move up and down within a defined number of standard deviations from their mean return over time.

If a sector is trading at the lower end of its expected long-term deviation from the mean, then it will ultimately become a buying opportunity.

Similarly, if a sector is trading too far over its mean, a correction will eventually occur to bring the sector back in line with its long-term returns.

A linear regression study can tell us how far a security has deviated from its mean return over a period of time.

When looking at linear regression lines, we track the volatility, or standard deviations, that surround the mean (average) line from point A to point B.

Each standard deviation theoretically represents 68.27 per cent, 95.45 per cent and 99.73 per cent of the prices that lie within one, two and three standard deviations of the mean.

The standard used by technical analysts is for two standard deviations away from the mean. This means that over the period of study for each of the following charts, the upper and lower lines contain some 95 per cent of the movements that have happened in the period of study.

Should the trend continue (as you know—trends can change), linear regression lines can offer a projection for the extent of movements in future.

I chose to look at a few sectors that typically have been either higher dividend paying, or have been beat down significantly–or both.

On the charts for these sectors, I started the linear regression lines (blue lines) at the point where the trend changed. We're assuming that the current trend is to continue until proven otherwise.

On the following page are charts containing linear regression lines for Canadian banks, U.S. and Canadian energy stocks, and Canadian utilities.

Canadian & U.S. energy

The linear regression line was set on the **iShares TSX Capped Energy Index Fund** (XEG-TSX, $9.26) from the 2009 lows.

Since that time, energy prices, and the producers, have been quite volatile. As you will see on the chart, there have been plenty of 30 per cent-plus swings in that six-year period. Yikes!

You can also see that the sector is getting close to the low line for two standard deviations. That line lines up with the 2009 lows.

On the U.S. **SPDR Energy Select Sector ETF** (XLE-NYSE Arca, US$55.97), I studied the linear regression lines going back to 2003.

That's a longer study period, hopefully making the lines more significant. It too shows a move back to the lower line.

My take: the buying point may soon approach us on the energy sector.

Wait for a consolidation before buying.

I expect to write future articles for *Investor's Digest* if, as, and when a consolidation may occur.

Canadian utilities

I drew the regression on the **iShares S&P/TSX Capped Utili-**

ties Index Fund (XUT-TSX, $18.83) only back to 2011 given the short history of that ETF.

The sector presented enough volatility to give us an indication of potential future volatility—assuming the trend doesn't change aggressively.

It appears that XUT is trading below its mean average line. It's bouncing off of the lower linear regression line.

That's probably a good sign for the sector.

My take: This sector should be one to consider for contrarian investors.

The September market malaise brought the BMO S&P/TSX Equal Weight Banks Index ETF (ZEB-TSX, $20.08) temporarily down to spitting distance of its lower linear regression line. Recently, the sector rallied, then stalled out.

My take: The fruit is not ripe for picking in the Canadian banking sector at this time.

Canadian banks

While not a short-term timing tool, regression analysis can offer a heads-up on upcoming opportunities, or upcoming pain.

You still have to await a consolidation and breakout (or breakdown) to establish a trend change. But having overbought or oversold securities that are trading near or at the lower linear regression zones on your watch list can be an excellent starting point.

Stay tuned to my future columns, and my blog (at valuetrend.ca) for some ideas that come out of these studies.

Keith Richards on BNN

I will be on BNN's call-in show MarketCall Tonight on Friday, Jan. 29, 2016 from 1 p.m. to 2 p.m. EST.

Tune in to BNN to catch me live on BNN's premier call-in show, where viewers like yourself can ask my technical opinion on the stocks you hold.

Call in with questions during the show's live taping between 1p.m. and 2 p.m.

The toll-free number for questions is 1-855-326-6266. You can also email questions ahead of time to marketcall@bnn.ca–it's important that you specify they are for me.

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