*Wilkinson O'Grady & Co., Inc.*
*499 Park Avenue*
*New York, New York 10022*
*Telephone 212 644-5252*
*Fax 212 644-5342*
*www.wilkinsonogrady.com*

*Donald M. Wilkinson*
*Chairman*

WILKINSON O'GRADY
*Global Asset Management*

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After five decades of downplaying dividends, boards of directors are beginning a positive change in their financial behavior. Today the dividend payout ratio for the S&P 500 is at an astounding 85-year low of only 28% of earnings. A smoothed average payout ratio would be around 50% of earnings being paid out to shareholders as dividends on an annual basis, which dovetails with the fact that almost 50% of the long-term return from the overall market has come from dividends and their reinvestment.

Starting around 1960, at the same time that the Federal government began rationalizing deficits as a positive for growth and at about the same time that growth by acquisition and financial engineering became fashionable, managements and boards of corporations began to talk and act as if they could allocate capital more wisely than shareholders. Thus began a long cycle in the corporate world that has deemphasized dividends. It is also true that earnings growth was easier to come by in those earlier decades.

Emerging from World War II, stocks commonly yielded 6% versus government bonds at 2%. Around 1959, stocks for the first time produced a dividend yield that was less than bonds and then have consistently done so up until 2008, when short-term government bond yields dropped below 2%. At present the S&P 500 yields 2% as does the U.S. 10-year government bond. For perspective, up until the 1960's it was thought that you sold stocks at a 3% yield and bought them back when that yield was close to 6%. But like all financial rules, this one was soon broken. Over the next forty years yields on S&P 500 stocks dropped, ultimately reaching 1% by 2000. Since then, yields have been rising but are still low.

What has caught our attention is the number of boards of directors of companies who are thinking about shareholders in a changed way and appear to be embarking on longer-term and more generous dividend policies.

By way of illustration, let me share two different and new dividend policies.

First, let's look at Microsoft. At $26, the shares are at the same price they first touched in 1998. Over the last 13 years, MSFT has grown its earnings but its P/E ratio has contracted to only 10X. In 2004, MSFT began paying dividends and now has a 25% payout ratio and an indicated yield of 3%. Yet, this progress has not moved the needle for the stock price. Think about this. If MSFT continues to grow at 10% a year for the next five years and the dividend grows at 13% a year, then in June of 2016 the company would probably earn about $4.25 and pay a dividend of $1.24, a payout ratio of 26%. That projects a yield of 4.7% at current prices. And with little P/E expansion, the shares likely would be selling at about $50. If the investment environment went sour, the total return at a 6% yield in 2016 would be -3%. The upside could be driven mostly by an attractive and growing dividend. We expect more technology companies like Microsoft to adopt attractive dividend programs.

Another new dividend policy has been introduced recently by the board of Newmont Mining. The company has tied its level of dividends to the level of the price of gold. The indicated rate of dividends on a trailing basis today is $1.40 per share which correlates to a $1,700 per ounce gold price. If the price of gold drops to $1,200 the dividend would drop to $0.50. Surely the stock would drop as well. On the other hand, if the price of gold moves above $2,200, then dividends on an annual rate should be above $3.00 per share. Thus a 30% increase in price could lead to a 100% increase in the dividend. This gets to be interesting…but only if gold prices keep rising.

This sea change in corporate board behavior is no doubt shaped by the more modest growth opportunities that pertain for most of the economy and the failure of *so many financial innovations*. It also appears to be shaped by a return of common sense and, we hope, corporate humility.

True earnings growth is always superior, but a good investment in today's economic environment looks like this: it is a company growing earnings in excess of 10% per annum that has a dividend payout ratio only in the 20% area. For this kind of company there may be reason to believe that dividends will grow 15% per annum going forward. Needless to say we also would need to see strong balance sheets and minimal debt. All things being equal, this formula could lead to a five-year double. Of course, all things are never equal.

As a reminder, over the last 50 years, the average yield on the S&P 500 has been 3% versus the current low 2% level. For perspective, at the bottom of the 2008 market decline, the S&P 500 had a yield of 3.7%. Overall, market yields have a great deal to do with both capital preservation and capital appreciation. Long term, a shift to paying dividends is a definite and long-term improvement in governance of corporate finance and a benefit to shareholders.

* *As of the date of this letter, Wilkinson O'Grady owned shares of Microsoft and Newmont Mining for some clients.*