

Reinvesting Dividends Can Pay Off

When you invest in stocks, you want their price to go up. But of course, you can't control the rise and fall of stock prices. However, there is a key element of investing that you can control — the number of shares you own. And in the long run, share ownership may be more important than rising stock prices in determining your long-term investment success.

Of course, you might think that the advice of “buy more shares” is easier said than done. After all, not everyone can easily find a lot of extra money to invest. But you don't need access to vast wealth to increase your share ownership — you just need to consistently reinvest your stock dividends.

Just how important are reinvested dividends to wealth accumulation, as compared to capital gains (the increase in stock prices)? Over the 135-year period from 1871 through 2003, owning stocks and reinvesting the dividends produced 97% of all stock market returns, with only 3% coming from capital gains, according to a major study done by Dr. Jeremy Siegel, one of the world's leading researchers on stock market performance. Other studies have also pointed to the importance of dividends as a component of total returns.

What are the implications of this disparity between the effectiveness of dividend reinvestment versus that of capital gains? First of all, it suggests that you may not want to spend an undue amount of time and effort in chasing after “hot” stocks, hoping for big capital gains. For one thing, by the time you buy these stocks, they may already be cooling off, but even more importantly, your focus on achieving large capital

gains may not be the best use of your financial resources.

Ultimately, the power of dividend reinvestment means, not surprisingly, that you may be able to help yourself if you look for quality dividend-paying stocks — and then reinvest the dividends, month after month and year after year.

With just a little research, you can find stocks that have paid — and even increased — dividends for many years in a row. (Keep in mind, though, that not all stocks will pay dividends, and even those that do can reduce or discontinue them at any time. Dividend reinvestment does not ensure a profit or protect against loss.) So, to help boost your share ownership, consider reinvesting the dividends back into the stock, rather than taking them as cash payments. If you do choose to reinvest your dividends, though, you will need to look to other types of investments to provide you with income, assuming you need some income from your portfolio, which may become more necessary during your retirement years. Your financial advisor can help you determine the appropriate investments to help provide this income.

But in any case, if you can do without the current income provided by dividends, give careful consideration to reinvesting them. Dividend reinvestment is not a glamorous investment strategy, and it won't help you “get rich quick,” but it can help you make steady progress toward your long-term financial goals — and that's a key dividend in itself.

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