DOW THEORY FORECASTS®

## Share the wealth

Sometimes, generosity is good business.

Companies can share their cash with stockholders in three ways:

1) Dividends.
2) Share buybacks.
3) Debt reduction.

Dividends represent the purest form of sharing, as they pass cash directly into the hands of the owners of the company. Buybacks and debt paydown provide indirect benefits that should, in theory, drive the stock's price higher over time. Buybacks help shareholders by shrinking the number of shares outstanding, and thus boosting the value of those remaining shares. Debt paydown strengthens the balance sheet, presumably reducing risk, while also cutting interest costs, which benefits the bottom line. All three styles of cash deployment can be considered components of shareholder yield.

Taken alone, only one of the above actions has a positive effect on share prices. Portfolios featuring the one-fifth of S&P 1500 stocks with the largest trailing 12-month reduction in debt or the highest yield lagged the average stock in a back-test since the end of 1994. This suggests investors shouldn't purchase stocks simply because they retire debt or pay fat dividends. Shares of companies that repurchased shares aggressively outperformed the typical stock, as did those with strong three year dividend growth.

In some cases, we couldn't test the desired statistic directly. We considered reductions in debt/capital ratios rather than reductions in debt, and declines in share count rather than actual buybacks, to cope with a lack of historical data.

Quadrix® can make a big difference. For all four of the above statistics, we also tested what would happen if, in addition to ranking in the top quintile (one-fifth) based on the original metric, we also required stocks to rank in the top quintile for Overall score. In all four cases, eliminating low Quadrix scorers boosted average annual portfolio returns by at least 2%, vaulting them above the return of the average stock, if they weren't already.

As we discovered, shareholder yield alone may not be a good determinant of future returns, partly because plenty of troubled companies turn to buybacks and debt paydown in an effort to curry favor with investors.

Regardless of how well (or poorly) shareholder yield predicts stock returns, all three of the components — dividends, buybacks, and debt reduction — reflect proactive efforts on the part of company management.