

MONEY & MARKETS

TIP SHEET

Dividend trends make Hahn cautious on stocks

Dividends don't lie, and lately they have been sending investors a message, says money manager Wilfred Hahn of Hahn Investment Stewards & Co. Inc.

Despite encouraging corporate profit results that continue to roll in, dividend trends suggest profit growth is headed sideways to down into the end of 2006, he says.

He interprets the signals to mean that U.S. corporate profits will decline by a minimum of 10 per cent by the end of 2006 from fourth-quarter 2004 levels.

A period of slumping dividends as a percentage of gross domestic product and flat or rising interest rates would spell bad news for the stock market.

In a note to investors, Mr. Hahn argues that the reality of the predicted profit downturn is not currently reflected in the stock market, despite recent weakness. As a result, he is adopting a more cautious stance on equities in the portfolios he manages.

The money manager has come to that conclusion by studying dividend payments, which have become increasingly appreciated for their "what-you-see-is-what-you-get"

quality after the many corporate accounting scandals in recent years. Because they are not subject to the gloss that sometimes covers income statements, management's decisions with respect to dividends can provide good insight into expected profit trends, he says.

For one thing, whenever dividend increases start to trail profit improvements, the move implies that management does not regard current profit levels as sustainable enough to ensure a permanent dividend increase.

Still, Mr. Hahn admits that many executives no longer view dividends merely as a means to gradual wealth accumulation but as a device to prop up share prices and achieve quick wealth effects. As a result, he has tweaked his models to take such distortions into account. He says dividends continue to remain high as a share of national income, and that means that future profit trends will eventually become dismal.

He warns that high dividend payouts are theoretically a sign of trouble -- not imminent prosperity -- because companies then have less money to pump into the capital investment that will drive future profit upturns.

Why listen? The last time dividends spoke, Mr. Hahn notes, he was alerted to a strong corporate profits rebound starting in late 2002. It was a factor that caused him to remove his deep "underweight" on equities in early 2003 in time to participate in the market recovery since then.

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