

Are stocks cheap based on dividend yields?

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The month of October saw stock markets worldwide plunge to record levels, driving up dividend yields. The current dividend yield on the S&P 500 stock index is 2.8%, the highest in 10 years and compares with a 1.8% yield in the same month last year. The S&P/TSX Composite index dividend yield is currently 4.0%, the highest in about 20 years, and up from 2.3% in October of 2007. This may be an indication of exceptional value in the stock market, but only if dividends are sustainable.

As shown in the accompanying table, the S&P 500 current dividend yield of 2.8%, while at a 10-year high, is below its 52-year average, ranking at the 35th percentile. On the other hand, the S&P/TSX Composite has an above-average current dividend yield of 4%, ranking at the 86th percentile, a level not seen since October of 1990. Historical dividend yields for both indices are shown in the charts on page two.

Due to weak earnings and the limited number of dividend cuts, 26% of stocks in the S&P 500 now have a payout ratio of more than 50%. In Canada, excluding income trusts, 8% of TSX companies have a payout ratio greater than 50%. In order to see what the current dividend yield would be if all companies limited their payout ratios to more reasonable levels, we applied maximum payout ratios of 70%, 60% and 50% to both stock indices (with the exception of Canadian income trusts which we maxed out at 100%). The following table displays the results of our dividend analysis.

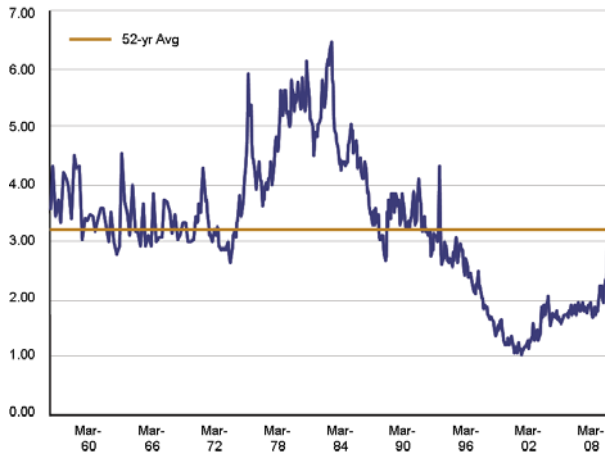
Market Index	Maximum Payout	Wtd Avg Dividend Yield	Percentile
S&P 500	current	2.8%	35
	70%	2.4%	30
	60%	2.3%	29
	50%	2.1%	26
52-year average		3.2%	50
TSX Composite	current	4.0%	86
	70%	3.5%	71
	60%	3.5%	70
	50%	3.4%	64
52-year average		3.1%	50

- Applying a 50% maximum payout reduces the S&P 500 dividend yield to 2.1% and the TSX dividend yield to 3.4;

At present, equity dividend yields are approaching the yield on 10-year U.S. government bonds and actually exceeding government yields in Canada. This may be an indicator of exceptional value in the stock market.

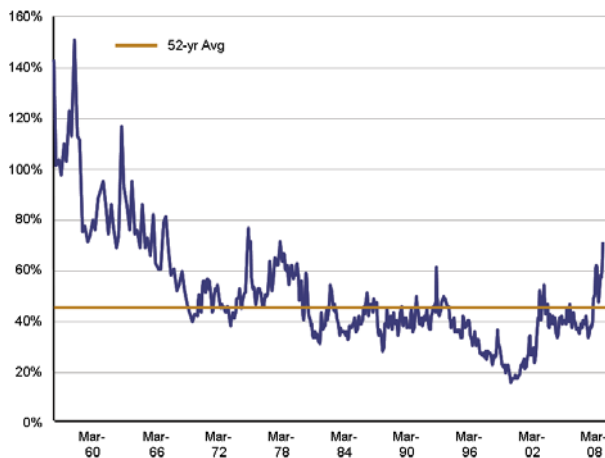
- The S&P 500's 2.8% dividend yield is 71% of 10-year Treasury yield of 3.92%; the ratio drops to 54% if we apply a payout maximum of 50%
- The S&P/TSX current dividend yield is 105% of 10-year Canadian bond yield of 3.81% or 81% if we apply a maximum payout of 50%.

S&P 500 Historical Dividend Yields



- The ratio of the S&P 500 dividend yield to interest rates is currently the highest it has been in 30 years.

S&P 500 dividend yield as % of US Treasury yield



- If we apply a 50% payout maximum, the ratio of dividend yield to interest rates remains well above average and in the case of Canada, it is still near its 50% high.

Dividends are latest quarter annualized; current dividend is as of November 3, 2008. Payout ratios are based on lesser of 2008 / 2009 estimated consensus earnings

Sources: Bloomberg, TD Waterhouse

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S&P/TSX Composite Historical Dividend Yields



- The ratio of TSX dividend yield to interest rates is at a level last seen in 1958.

S&P/TSX Composite dividend yield as % of Canadian government bond yield

