

NFJ Value Equity

May 2010 Market Review



Dividends and Volatility

The coming decade will be characterized by **volatility** and **inflation** (the next NFJ strategy piece)—both of which are a function of higher and growing levels of financial leverage within the Western world’s economic system.^[1] This is what investors should be focusing on. What holdings can I own that are not so volatile? Where can I invest to preserve the “real” value of my portfolio? These are the questions investors should be asking.

When we talk about volatility we are talking about price returns on a day by day basis. We would like to share with you an astounding statistic that you have probably never seen or heard before. We want to emphasize this important comparison by asking a couple questions. How many days between 2000 and 2010 did the S&P 500 Index move more than +/- 2.5%? Write your guess down—just take a stab at it. Now, how many days between 1950 and 2000 (50 years) did the S&P 500 Index move more than +/- 2.5%? What’s your guess? The answers are in the footnote.^[2] So far this year the volatility has continued:

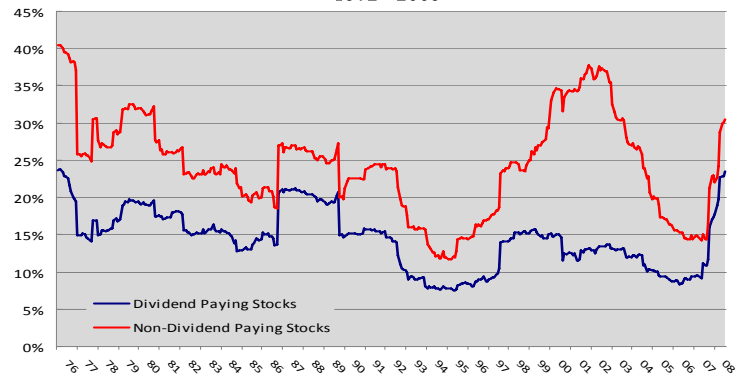
S&P 500 Gains	S&P 500 Losses	Russell 2000 Gains	Russell 2000 Losses
May 10 th 4.4%	Jan 22 nd -2.2%	Jan 4 th 2.4%	Feb 4 th -3.4%
	Feb 4 th -3.1%	Mar 1 st 2.2%	Apr 27 th -2.4%
	Apr 27 th -2.3%	Mar 5 th 2.1%	Apr 30 th -2.9%
	May 4 th -2.4%	Apr 14 th 2.2%	May 4 th -3.2%
	May 6 th -3.2%	Apr 29 th 2.1%	May 6 th -3.8%
		May 3 rd 2.3%	May 7 th -2.9%
		May 10 th 5.6%	

At this point we imagine that some investors may say, “I don’t care about the short term volatility as long as it gets me to where I want to go. I have a longer term focus.” They are missing something. They are missing how volatility works against them over time. To illustrate what we mean we would like you to focus on the table below:

Period	Lower Volatility		Higher Volatility	
	Return / Growth of \$100	Return / Growth of \$100	Return / Growth of \$100	Return / Growth of \$100
Period 1	2.0%	\$102.00	10.0%	\$110.00
Period 2	-2.0%	\$99.96	-10.0%	\$99.00
Period 3	2.0%	\$101.96	10.0%	\$108.90
Period 4	-2.0%	\$99.92	-10.0%	\$98.01
Period 5	2.0%	\$101.92	10.0%	\$107.81
Period 6	-2.0%	\$99.88	-10.0%	\$97.03
Period 7	2.0%	\$101.88	10.0%	\$106.73
Period 8	-2.0%	\$99.84	-10.0%	\$96.06
Period 9	2.0%	\$101.83	10.0%	\$105.67
Period 10	-2.0%	\$99.80	-10.0%	\$95.10
Cumulative Return	-0.20%	\$99.80	-4.90%	\$95.10
Average & Standard Deviation	0% +/- 2.1%		0% +/- 10.5%	

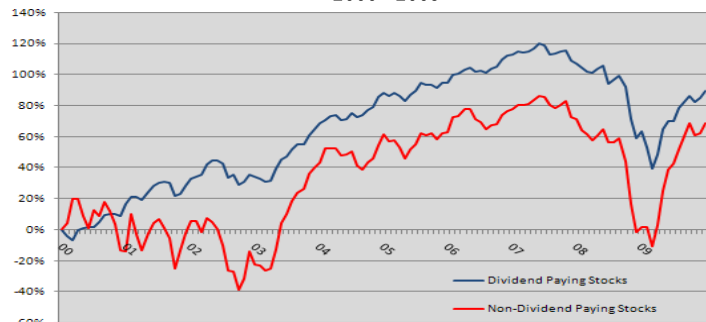
Now isn’t this interesting? Here are two series of returns. They have the same simple average but one is five times more volatile than the other—kind of like the last decade compared to the previous 50 years. What’s the lesson? *Volatility works against the benefits of compounding returns.* If you know this, what are you asking? You are asking, what kind of stocks have lower variability of returns, and this is the point where we have an answer for you.

36-Month Trailing Annualized Standard Deviation ^[3]
1972 - 2009



There are not many constants in the investment management business—constants meaning things you can count on. These are things where an investor understands that this is just the way it is. What we have here in the above graph is one constant. Dividend paying stocks have consistently had much less volatility than non-dividend paying stocks. **In market environments where volatility rears its ugly head, dividends are important. They magnify the investor’s edge.** The graph below charts the performance of dividend and non-dividend paying stocks over the last decade.

Dividend Paying Stocks vs. Non-Dividend Paying Stocks ^[4]
2000 - 2009



This second graph illustrates three important points. The first is obvious. Dividend payers outperformed the non-dividend payers in the last decade. The second point is less apparent. Non-dividend paying stocks bounced around considerably more. The period between 2000 and 2002 was a bad one for non-dividend payers, but then in 2003 they spiked upward, then a plunge in 2008 and early 2009, and a spike upward in 2009. This is the kind of volatility that we are writing about. The third point has to do with timing. Investors in non-dividend paying stocks would have performed favorably if they had started in 2003 or 2009—they had to get the timing right.

Over the years we have been aware of this phenomenon, and it is one of the reasons that in over two decades of investing we have never taken a position in a company that did not have a dividend policy. We see the dividend paying selection universe as a better fishing pond—it's a place where there are not as many snags. NFJ may be the only value manager out there that has consistently adhered to a discipline of selecting holdings exclusively from a universe of dividend paying companies.

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Recently we started thinking about how this discipline benefited us a little more in the last decade. Not only did dividend paying stocks perform favorably, they did so with less volatility. *In the last decade the volatility amplified the favorable return of dividend paying stocks—that was important.* We are expecting more of the same. The past decade's performance and the volatile market environment are strong reasons to believe that dividend paying stocks will continue to be favored in the equity markets. ■

^[1] NFJ Investment Group Market Review February 2010

^[2] There were 162 trading days between 2000 and 2010 when the S&P 500 rose or fell > or < +/- 2.5%, and there were 160 trading days between 1950 and 2000 (50 years) when the S&P 500 rose or fell 2.5%.

^[3] Ford Investors Services Universe: Universe size increases over time from approximately 800+ companies in 1970 to over 5,000 currently. Companies within each time series of returns are equal weighted.

^[4] Ford Investors Services Universe

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