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STOCKS

Falling Bond Yields Make Equities Hard to Ignore

Nearly 60% of S&P 500 stocks offer dividend yield of at least 1.7%, beating 10-year U.S. Treasurys

By Michael Wursthorn

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A plunge in bond yields has left investors with few alternatives to stocks.

The latest flare-up in trade tensions has quickened investors' flight to haven assets, pushing bond yields down to their lowest levels in years. Wall Street analysts say the pullback in yields, along with a new phase of monetary loosening by central banks around the world, should give investors a new rallying cry for the second half of the year: "There is no alternative" to stocks, known as the Tina effect.

Nearly 60% of stocks in the S&P 500 offer a dividend yield of at least 1.7%, according to FactSet, better than the 1.640% yield where 10-year U.S. Treasurys settled Monday. AT&T Inc., T **-1.48%** ▼ cereal maker General Mills Inc. GIS **-0.33%** ▼ and memory chip company Western Digital Corp. WDC **-3.87%** ▼ are among the highest-yielding—and best performing—stocks in the index this year. Each has dividend yields of at least 3.6%, while yields across the broad index average about 2%.

The percentage of outperformers is among the highest of the more-than-a-decade-old bull market, says Keith Lerner, chief market strategist at SunTrust Advisory Services. He added that, on average, about 17% of S&P 500 stocks have carried dividend yields exceeding those of 10-year Treasurys since 1990.

The allure of steady, income-generating stocks is expected to be a stabilizing force for major indexes in the months to come.

"This is a hard period for most investors to navigate through," says Brent Schutte, chief investment strategist at Northwestern Mutual Wealth Management. "But stocks are supported by low bond yields as long as we don't have a recession."

A mix of trade tensions and fears that growth is slowing around the world have dented the stock market's rally. The S&P 500 has stumbled 3.3% so far this month, knocking its year-to-date gain to 15%. Investors, meanwhile, have stepped up their flight to haven assets, pushing bond yields down.

During the pullback, analysts at UBS Group AG and Wells Fargo Investment Institute, among other firms, have been urging investors to buy dividend-generating stocks, especially those that are less susceptible to trade tensions.

Dividends pad stock returns and offer investors a steady stream of income. Taking dividends into account, an S&P 500 index that measures total return is down just 2% this month and remains up nearly 18% for the year.

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Dividend-paying stocks can help insulate investors from the worst of a pullback. When the S&P 500 fell 6.6% in May following renewed trade anxieties, a UBS portfolio including Home Depot Inc., HD **-2.77%** ▼ McDonald's Corp. MCD **-0.83%** ▼ , JPMorgan Chase JPM **-4.19%** ▼ & Co. and other dividend-paying stocks with below-average exposure to China fell a more modest 3.7%.

Investors, however, need to consider more than just a company's share payout, according to analysts. Some of the highest-dividend-yielding stocks are among the market's worst performers this year. In some cases, yields are higher because stock prices have fallen. Too high of a yield can be a sign of distress. The dividend yield of the telecom company CenturyLink Inc. CTL **-1.61%** ▼ stands at 9.3%, but shares have slid 26% in the midst of broader turmoil for telecoms.

S&P 500 energy stocks carry a yield of 3.8%, the highest of the broad index's 11 major sectors. But worries of a supply glut have hurt shares of energy stocks this year. The sector has slid 8.9% since the end of June, cutting its year-to-date gain to 1.3%.

The disconnect between dividend yields and bond yields can be a factor of tepid economic growth, and it can spill over into the stock market. Take Japan, for example. The Nikkei 225 has had a higher dividend yield than what is offered by 10-year Japanese government bonds for more than a decade, but modest economic growth has weighed on returns. The S&P 500 has risen more than 700% over the past 30 years, compared with a 40% contraction in the Nikkei.

"Markets have to be very confident about the future, as well as the stability of a dividend going forward," says John Vail, chief global strategist at Nikko Asset Management.

Investors should seek companies that have solid growth trajectories and pay healthy dividends, rather than those that offer the biggest payouts, says Mr. Vail. Utilities and consumer-staples companies, for example, pay some of the highest dividends, but those companies have been fighting pricing pressures and tend to grow more slowly than those in the technology and communications sectors.

Technology companies in the S&P 500 sport a dividend yield of 1.4% and have risen 25% this year, as investors concentrate on companies with the potential to expand sales and profits.

Apple Inc. AAPL -2.65% ▼ carries a 1.4% dividend yield, matching the broader sector's average, and is up 27% for the year (nearly 29% on a total-return basis). Several companies that pay richer dividends are doing just as well, if not better. Semiconductor company Lam Research Corp. LRCX -3.82% ▼ has a 2.3% yield and is up 44% this year, while International Business Machines Corp. 's 4.6% yield juices the computing giant's total return to 22%, compared with 18% on the basis of price change.

At the same time, stock valuations have improved as major indexes pull back from their July records—an enticing factor for price-conscious investors who thought shares of many companies were getting expensive.

The S&P 500 is trading at 16.3 times its earnings over the next 12 months, down from more than 17 times in July, according to FactSet. Analysts at Goldman Sachs and other firms say the broad index could comfortably reach a valuation of 18 times by year-end, as long as interest rates fall or remain stagnant.

"Dividend yields are going to come into play for people looking to nibble at opportunities in the stock market," says Mr. Lerner. "Even if you're more bearish, then equities that pay dividends are going to help buffer portfolios during periods of uncertainty."

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