We recently spoke with Jeremy Deal, managing partner of JDP Capital Management, about the research he has done into dividend-paying stocks. John Mihaljevic spoke with Jeremy about the results of his study.

Here is how Jeremy summarizes his research:

Five-year study results: As of October 2012 there were 359 stocks in the U.S. market with a 4% or greater yield ("yield-oriented stocks"), over $100 million market cap, all industries, no funds.

How did these stocks perform over the next five years (through October 2017) in an ultra-low interest rate environment?

- 25% outperformed the S&P total return by serving only Master #1
- 5% outperformed the S&P total return serving Master #1 and #2
- 1% outperformed the S&P total return serving Master #1, #2, and #3
- 75% of the underperformers served all three Masters

Can't have your cake and eat it too: *Serving the "Dividend Masters" greatly increased the odds of underperforming over time.*

Master #1: Management commitment to paying a dividend as the primary use for excess capital. Generally large mature C corps, variety of industries.

Master #2: Structurally committed to "manufactured yield" which relies on capital markets to fund growth and sustainability while using cash flow + depreciation to fund the dividend. This is accomplished by continuously selling stock or/or high-risk short-term debt to fund business needs. Typically found in LP/GP structures in a variety of industries.

Master #3: Commitment to a highly capital-intensive business and sell "safety" to investors. Capital-intensive businesses require re-deploying profits back into the business to maintain them, while growth is financed with long-term, low cost debt. Serving this "Master #3" is fine if you are not also serving Master #1 and Master #2.

Study Results

A combination of all three Masters was the most common trait of failed dividend stocks. Investors often blame sector downturns, or movements in interest rates for losses. However most losers in the study were victims of risky financial engineering and management incentivized to grow the dividend at all costs (IDRs, management fees, etc.). This avoidable structural risk is often masked by the ownership of high quality, predictable infrastructure-like assets that, if not bastardized, are in fact low risk.