



# Income Builder Weekly

Visit us on the web at: [www.gaiacapital.com](http://www.gaiacapital.com)

Gaia Income Client Weekly Newsletter Feb. 28, 2009

## Dividend Cuts - Patterns Suggest Pockets Of Safety

In a bear market, there is little refuge for price-only investors (those who rely only on capital appreciation through price growth only). It may seem that way for a time, but usually everything gets leveled - perhaps at not the same rate (down 50% for example, rather than down 70%). Dividend maintenance is actually another matter entirely.

Dividends correlate to cash flow, which most often correlates with earnings, but the association is nowhere near perfect due to things like write-offs, depreciation, amortization, etc. Dividend maintenance correlates well with company confidence that this quarter's profits will not be needed to shore up the company during future quarters. The recent cut of the dividend by General Electric was all about conserving cash - some \$9 billion of it - against liabilities which could crop up, especially in GE Capital, the company's "bank." The job for us is simple - on the surface.

Job no. 1 with us is to keep your income flowing. To do that well, we must invest in companies which will maintain all or most of their dividends throughout this down cycle. Doing so requires some foresight and some reinforcement of our guesswork. Our first job is to avoid "holes in the road," to use a driving example. One would likely find roads pocked with holes in banks, highly leveraged companies whose debt payments were a struggle in good times and are now almost impossible, companies highly exposed to consumer spending, companies holding a large number of securitized assets which are falling in value and in companies exposed to Europe and to weak emerging markets. Last year, when it appeared that we would suffer only a mild recession, we adjusted accordingly. After October, when it became apparent that the downturn would be more severe, we began looking for more "bullet proof" companies. Note - the bullet proof companies may not be the best investments in normal times, but for now they are the place to be for the most secure income. The point? The economic climate determines to a large extent the best and worst investments.

Interestingly, one really needs to take a company by company approach. For example, in the consumer area one sees massive deterioration of earnings and stock prices among many retailers, homebuilders and other consumer/housing names. But Amazon.com is doing decently, as is Wal-Mart. Both of these companies are low price leaders. In this environment, the Saks and Tiffany's which did well in the last cycle are not doing so in this one.

We have concentrated on companies with predictable, mostly steady earnings. We have found them among Master Limited Partnerships, packaged food, certain Real Estate Investment Trusts and so on. The common denominator: companies with predictable cash flow, excellent management, low debt and good insider (management and directors) participation in the stocks we buy. That latter point can't be overestimated. When the CEO of a company owns 4% of the entire block of shares a company has issued, then his or her interests are aligned with ours - the stock he or she owns is a significant part of the overall net worth. Our method is not foolproof, but it does point us to areas that

might do better than others and to companies which will survive and continue to pay dividends in this downturn.

### **The Take-Away**

Dividend cutters during this cycle are following a pretty well defined pattern - those who participated the most in the last cycle are being taken down the most. Some companies may not have participated but are caught in the destruction derby of stocks. We want to avoid them, too. The fairly well defined list of dividend cutters suggests that there may be pockets of safety into which we may retreat - at least for now if not for longer. And so we have, and so you may rest more comfortably.

Thank you for investing with us.

*Jim Pursley*

*The opinions contained in this report represent the author's current knowledge and are based on sources known to him at the time of writing. Such opinions are subject to change at any time and are presented for educational value. Any other use, such as investment solicitation, is inappropriate and absolutely unintended by the author. Readers must evaluate information herein presented.*

---

James C. Pursley, Chief Investment Officer . Email [jim.pursley@gaiacapital.com](mailto:jim.pursley@gaiacapital.com)  
PO Box 823, Forest Grove, OR 97116-0823 . Phone (800) 395-6636 Fax (503) 992-8446