



Building a Dividend Growth Portfolio from Scratch: 15 A Rated or Better Fairly Valued Opportunities

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Introduction

We remain in one of the longest bull markets in history. Generally, with bull markets stocks tend to become highly valued. Additionally, we also continue to find ourselves in a low interest rate environment based on historical standards. However, after bottoming out in January 2017, interest rates have steadily increased. Although interest rates remain low based on historical norms, the fear of rates rising in the future has begun to unsettle the stock market.

So far, October 2018 has brought us dropping stock prices. Consequently, there has been the beginnings at least of a correction in the valuations of many high-quality dividend growth stocks. This is important, because for the most part, high-quality dividend growth stocks had become quite expensive. Although the correction has been broad-based, there are certain sectors such as the financial sector and the healthcare sector that have been hardest hit.

Furthermore, although stock prices have generally been falling recently, I think we are far from calling it a true correction and certainly far from calling it a bear market. The following earnings and price correlated FAST Graph on the S&P 500 puts the recent weakness into a clear perspective.

The S&P 500 Current Valuation Based On Past Results

The following earnings and price correlated FAST Graph on the S&P 500 since calendar year 1999 illustrates the overvaluation that has become manifest since the Fall of 2013. Moreover, we see that the dropping stock prices experienced this month had not made a material difference in valuation. Obviously, every little bit helps, but the S&P 500's valuation remains high based on historical norms and a longer term earnings growth rate of 6.8%.

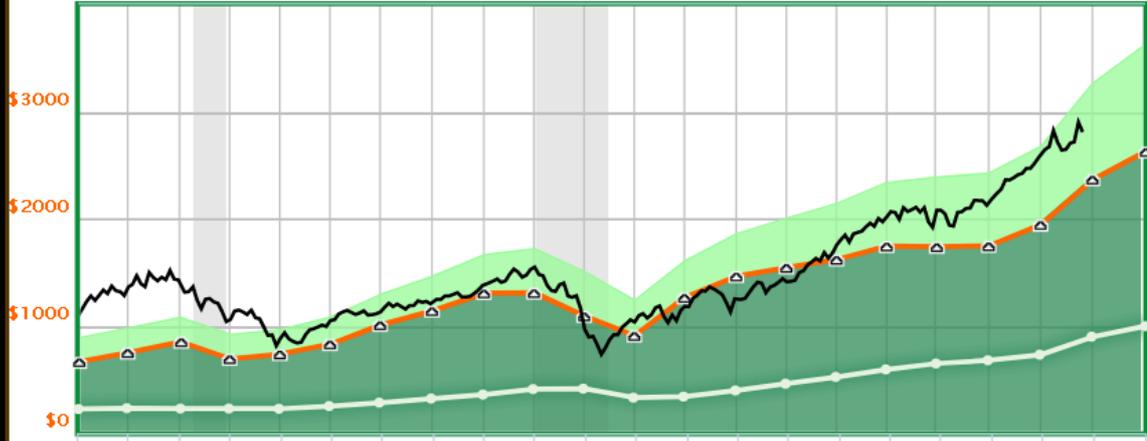


S&P 500(^SPX)

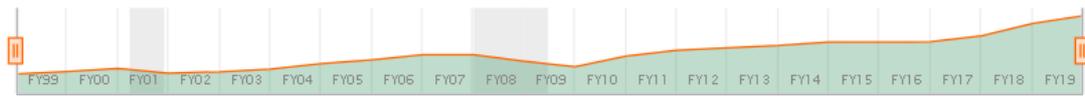
20Y 19Y 18Y 17Y 16Y 15Y 14Y 13Y 12Y 11Y 10Y 9Y 8Y 7Y 6Y 5Y 4Y 3Y All

Year	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
High	1469	1527	1374	1173	1112	1214	1273	1427	1565	1447	1128	1260	1364	1466	1848	2091	2131	2272	2690	2873	N/A
Low	1212	1265	966	777	801	1063	1138	1224	1374	752	677	1023	1099	1277	1457	1742	1868	1829	2239	2329	N/A

FAST FACTS	
10/16/2018	
Price: 2809.92	
0	
P/E: 18.5	
Div Yld: 1.8%	
Color Coded	
Recessions	
Dividends Declared	
Dividends	
Normal P/E Ratio 18.0	
Adjusted (Operating) Earnings Growth Rate 6.8	
GDF...P/E=G 15.0	
Market Cap. 10000.000 Bil.	
37% Debt/Cap	
0	
0	
SETTLEMENT PRC	
Stock Splits (0)	



FY Date	12/99	12/00	12/01	12/02	12/03	12/04	12/05	12/06	12/07	12/08	12/09	12/10	12/11	12/12	12/13	12/14	12/15	12/16	12/17	12/18	12/19
EPS	50.02	56.78	46.16	49.12	55.36	67.30	76.06	87.10	87.29	72.81	60.63	84.31	97.65	103	108	116	116	116	130	158	175
Chg/Yr	13%	14%	-19%	6%	13%	22%	13%	15%	0%	-17%	-17%	39%	16%	5%	5%	8%	0%	1%	11%	22%	11%
Div	15.48	15.25	15.28	15.15	16.81	18.94	21.52	23.95	27.38	27.66	22.05	22.71	26.51	30.74	34.95	39.61	43.31	45.30	48.77	60.00	66.55



- Price ● Normal PE ▲ EPS ● EPS Ovd ● Dividends POR ● Dividends ● Dividend Yld

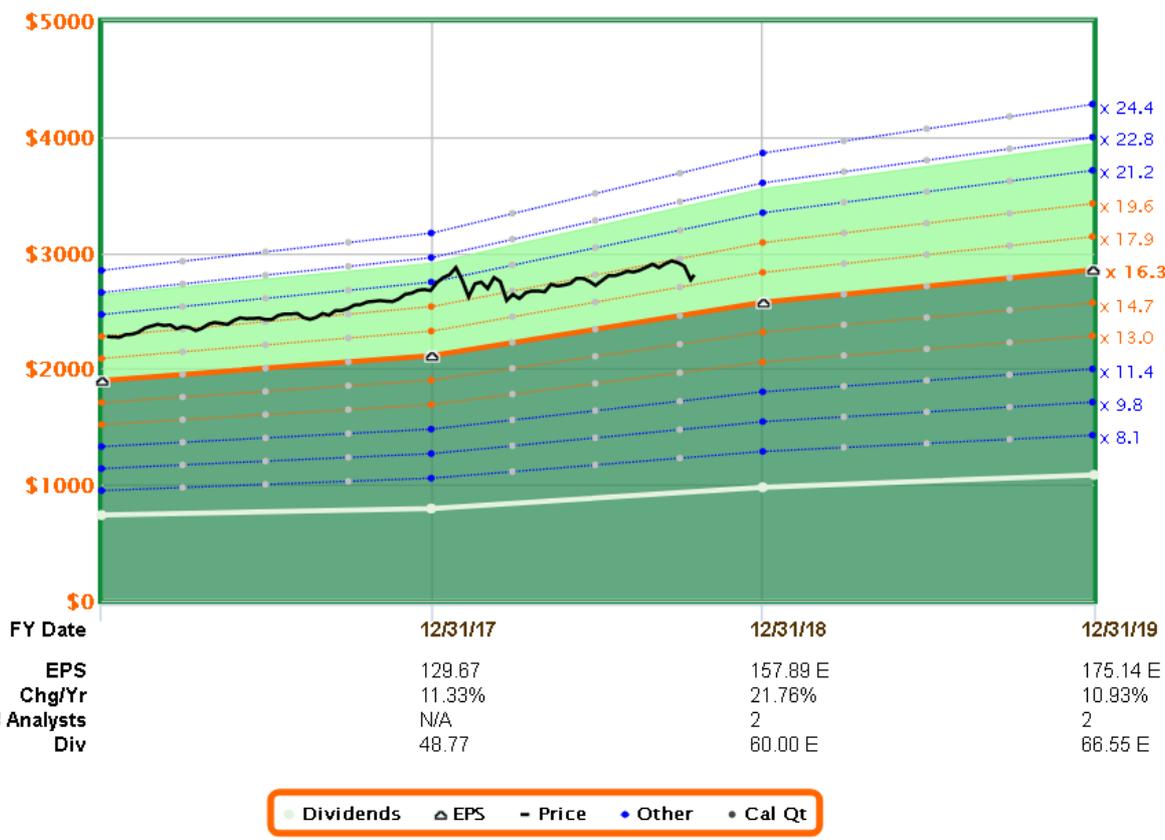
✖ Reset Selections Tip: To toggle lines on the graph click corresponding legend item

The S&P 500 Valuation Based on Forecasts

From a historical perspective seen above, the S&P 500 is clearly overvalued. On the other hand, from a future perspective, it can be argued that the S&P 500 is simply fully valued but within the valuation corridor depicted by the light orange lines on the forecasting calculator below. The primary differentiator is a forecast for future growth of 16% versus the historical growth of 6.8% we saw on the long-term historical graph.

S&P 500(^SPX)

FAST FACTS	
10/16/2018	
Price: 2809.92	
P/E: 18.5	
Div Yld: 1.8%	
Color Coded	
Est. Dividends Declared	
Dividends	
Estimated Earnings Growth	16.3%
P/E=G	16.3
Capital IQ	
Market Cap.	10000.000 Bil.
37% Debt/Cap	
	0
	0
SETTLEMENT PRC	
Stock Splits (0)	
Analyst Scorecard	
1Y	N/A
2Y	N/A



Stock prices have dropped, but in my opinion and as illustrated in the above graphics, the general drop in stock prices has been benign relative to the reaction of many investors. Stated differently, valuations for the general market have not really changed much at all. On the other hand, as previously stated, there are certain sectors that have been hit much harder. However, I do contend that most high-quality blue-chip dividend growth stocks remain excessively valued.

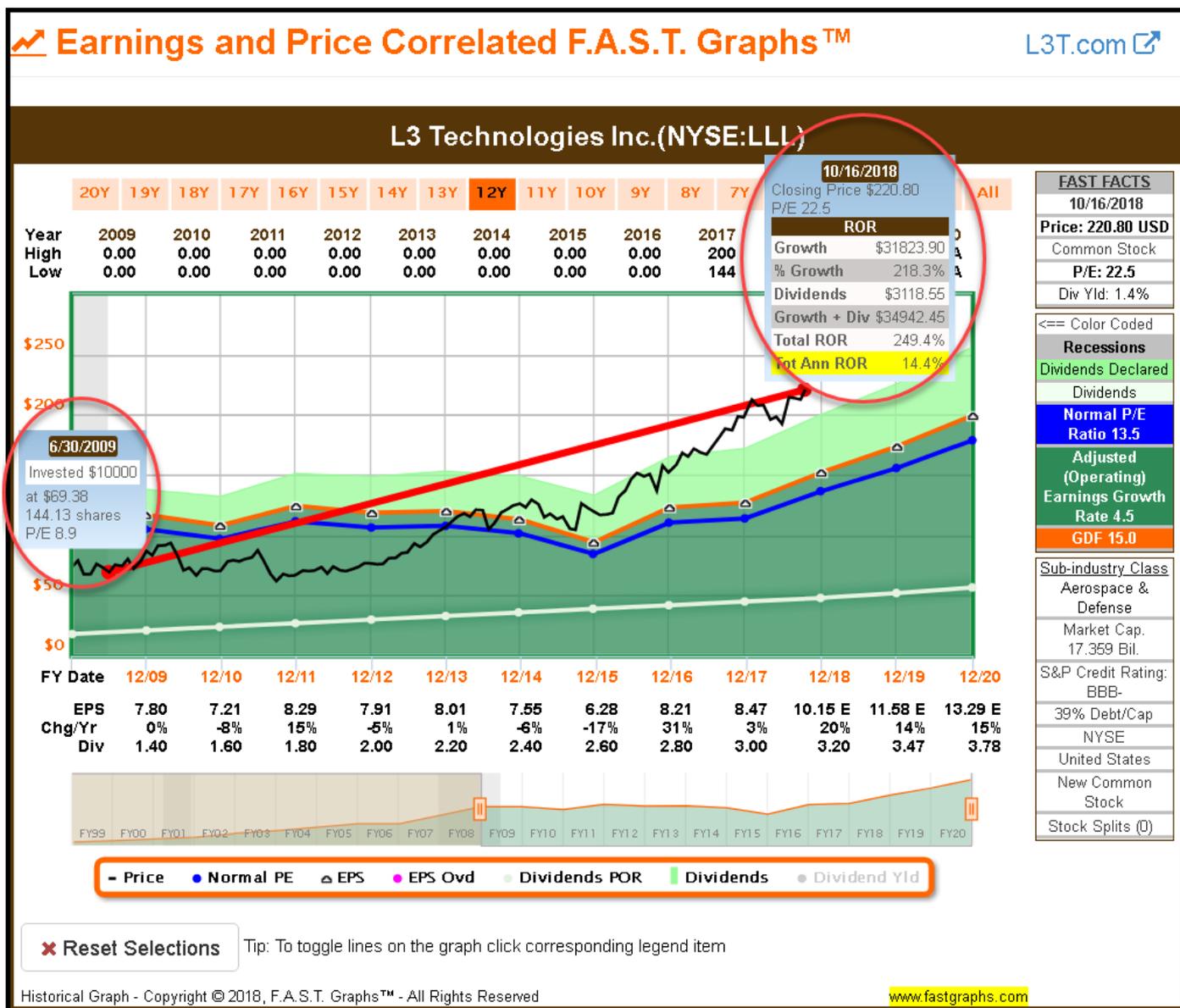
This presents a conundrum of sorts to the dividend growth investor that would like to create a long-term dividend growth portfolio in today's market. Although it is harder to accomplish in a strong bull market like we have today, it can be done. It has long been my contention that attractive valuations can be found in all market environments. Clearly, there is more value to be found in a bear market and less value to be found in a strong bull market like we have today. Consequently, it is harder to find attractive dividend growth stocks in today's bull market, but not impossible. Nevertheless, as I will illustrate later, it is a market of stocks and not a stock market.

There's More Than One Way to Skin A Cat

In my most recent article I covered Whirlpool Corporation which I considered a fair company at a wonderful price. As a result, I was called to task by several readers citing the popular Warren Buffett quote: "It's far better to buy a wonderful company at a fair price than a fair company at a wonderful price." Frankly, under normal stock market valuation scenarios, Warren's quote represents my preferred method of building a stock portfolio. However, in today's bull market it has simply been difficult to identify enough high-quality companies available at fair prices with which to build a portfolio upon.

Personally, I have been dealing with this frustration for some time. Nevertheless, even though it may technically be better (safer) to buy a wonderful company at a fair price, this doesn't mean that investing in a fair company at a wonderful price is a bad idea. For example, in 2009 I wrote an article on L3 Technologies Inc., that I considered a fair company (BBB-S&P credit rating) but at a wonderful price represented by a P/E ratio of only 8.9.

Had an investor invested in L3 Technologies on June 30, 2009 and held it until yesterday's close, the total annualized rate of return would have been 14.4%. That is a rate of return that I would take every day of the week. However, if you notice on the following graphic, earnings-per-share growth from 2009 through 2015 was negative, further indicating L3 Technologies as only being a fair company. Nevertheless, it proved to be an excellent investment. In short, there are exceptions to every rule.



15 High-Quality A- Rated (or Better) Fairly Valued Dividend Growth Stocks

Even though I consider the market correction cited above more benign than many people, it was enough to bring several high-quality dividend growth stocks into attractive valuation levels. More to the point, the correction was enough to produce 15 high-quality attractively valued dividend growth stocks that can be utilized as the foundation for building a dividend growth portfolio from scratch. To be clear, I consider each of the following research candidates wonderful companies available at fair or attractive prices (valuations).

To be included on this list, my selection criteria and process was simple and straightforward. Each company had to be rated A- or better by S&P. Additionally, each company had to pay a dividend that has grown at above-average rates. But most importantly, each company had to have produced a consistent above-average historical earnings growth rate and the expectations for continued growth going forward. Simply stated, I was looking for high quality dividend growth stocks (wonderful businesses) available at attractive valuations with the opportunity to generate above-average long-term total returns.

The following portfolio review presents my 15 wonderful businesses at fair prices in alphabetical order: AbbVie (ABBV), AmerisourceBergen (ABC), Ameriprise Financial (AMP), BlackRock (BLK), Comcast (CMCS.A), Intel (INTC), Illinois Tool Works (ITW), JP Morgan Chase (JPM), Altria (MO), PepsiCo (PEP), Principal Financial (PFG), Prudential Financial (PRU),

Simon Property Group (SPG), State Street Corp (STT), U.S. Bancorp (USB):

Ticker	Name	CR	Sector	P/E	P/CF(FFO)	EPS Yld	CF(FFO) Yld	Div Yld	Market Cap	LT D/C
ABBV	AbbVie Inc.	A-	Health Care	12.1	12.7	8.3%	7.9%	4.3%	137.329 Bil.	72.000
ABC	AmerisourceBergen Corpor	A-	Health Care	13.7	9.8	7.3%	10.2%	1.7%	19.143 Bil.	64.000
AMP	Ameriprise Financial Inc	A	Financials	9.8	12.3	10.2%	8.1%	2.7%	19.262 Bil.	43.000
BLK	BlackRock Inc.	AA-	Financials	16.1	14.4	6.2%	6.9%	2.9%	68.765 Bil.	13.000
CMCSA	Comcast Corporation	A-	Telecom Svc	14.5	7.0	6.9%	14.3%	2.2%	158.627 Bil.	43.000
INTC	Intel Corporation	A+	Info Tech	11.1	7.5	9.0%	13.4%	2.7%	206.942 Bil.	26.000
ITW	Illinois Tool Works Inc.	A+	Industrials	17.7	15.4	5.7%	6.5%	3.0%	43.821 Bil.	57.000
JPM	JPMorgan Chase & Co.	A-	Financials	12.1	NMF	8.2%	0.0%	3.0%	359.396 Bil.	0.000
MO	Altria Group Inc.	A-	Cnsmr Stpls	15.9	15.8	6.3%	6.3%	5.2%	113.223 Bil.	44.000
PEP	PepsiCo Inc.	A+	Cnsmr Stpls	19.0	16.2	5.3%	6.2%	3.5%	148.610 Bil.	67.000
PFG	Principal Financial Grou	A-	Financials	9.6	3.8	10.4%	26.6%	3.9%	15.701 Bil.	19.000
PRU	Prudential Financial Inc	A	Financials	8.2	3.1	12.2%	32.3%	3.7%	40.835 Bil.	21.000
SPG	Simon Property Group Inc	A	REITs	24.5	14.4	4.1%	7.0%	4.7%	52.932 Bil.	77.000
STT	State Street Corporation	A	Financials	11.1	4.4	9.0%	22.8%	2.3%	30.907 Bil.	0.000
USB	U.S. Bancorp	A+	Financials	12.8	13.1	7.8%	7.6%	2.9%	82.739 Bil.	0.000

FAST Graphs Analyze Out Loud Video: 15 Wonderful Dividend Growth Stocks at Fair Prices

In the following analyze out loud video I will elaborate on the attractive valuation I see in each of the 15 wonderful dividend growth stocks. However, an important caveat that relates to value investing is in order. The venerable Warren Buffett offered a profound quote that supports what I am about to offer. Warren suggested that, “you can’t buy what’s popular and expect to do well.” To this profound quote I would like to add the extension – over the longer run. Popular stocks can perform well in the short run, but the day of valuation reckoning inevitably manifests over the long run.

The primary implication and importance of Warren’s message speaks directly to value investing as a long-term strategy. Over short periods of time, stock prices can and often will behave quite irrationally. However, over the long run the value of the business shines through. Consequently, successful value investing requires holding your stocks long enough for the business results purchased at sound valuation to reward you.

Summary and Conclusions

In closing, value investing requires the implementation of a long-term strategy. Out-of-favor stocks can stay out-of-favor, and as a result continue dropping even if you purchase them at attractive values. However, as Warren Buffett also taught, “Price is what you pay, value is what you get.” Therefore, competent and intelligent value investors are prepared to suffer short-term price weakness. They can do this with the confidence that inevitably stock prices will move into alignment with intrinsic value.

With that said, I believe the 15 stocks featured in this article represent excellent long-term opportunities. They are all high-quality companies which are expected to continue growing in the future as they have in the past. However, for various reasons they are also out-of-favor. But never forget, that bargains are rarely found in the most popular stocks. The key is to recognize the fundamental value and buy them when no one else wants them. Do this, and solid returns at lower-than-typical levels of risk are sure to follow.

Disclosure: Long ABBV,ABC,AMP,INTC,PEP,PFG,STT

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