

## **The Magic of Dividend Reinvestment**

By Mary Ann Golin, CFP®, CRPC

It is never too early or too late to make money in the stock market. Unfortunately, many people think the stock market is speculative and overlook some of the simple, low cost, safe, and easy ways to make money. One of the most boring but amazing ways of growing a nest egg is to buy one or more dividend-paying common stocks, set them up to have the cash dividends buy more shares of stock, and watch the account grow.

There are many solid stocks to pick from. These are investment stocks, not speculative stocks. Utilities are an excellent example of stocks which pay a good dividend, offer dividend reinvestment, and seldom have large price swings. Besides, everyone pays their utility bills so utility companies are known for their price stability. It is easy to find a utility stock paying 4% annually in cash dividends. One need only look at their monthly electric bill to find a likely candidate and what better way to get a rebate on your electric bill!

First, there must be some available cash, say \$10,000. Next, select a stock that pays dividends. Utilities are a good example but many of the large cap companies such as banks, also fit into this category. Buy as many shares of the selected stock as the available funds will allow then request that the shares be put on dividend reinvestment status. This can be done with most brokerage companies or if the stock certificate is issued, then the dividends can be reinvested directly with the issuing company. Assuming a 4% annualized dividend rate and remembering that most stocks pay dividends quarterly, this is a good way to compound the yield. In fact, at the 4% rate with a company that maintains a flat dividend, in just about 5 years, the effective annual yield on the original \$10,000 becomes 5% due to the compounding effect of dividend reinvestment. Once in a program like this, most investors will hope to see the stock price drop a little, especially around dividend time because more shares can then be purchased and the additional shares throw off more dividends which buy more shares, and so on.

There are a couple of important caveats. Regardless of whether the reinvestment is done at the brokerage house or with the company directly, there is a small fee, usually \$2 to \$3, to cover the cost of record keeping and statements. Many people mistakenly think that this service is free if done directly with the issuing company. The other caveat is that these dividends are reported as income. The tax rate for dividend income is greatly reduced depending on one's tax bracket. Those in the 25% bracket or below are subject to a 5% rate on this dividend income, and those above the 25% bracket are subject to a 15% rate on dividend income. IRS Publication 550 explains the applicable rules.

This is a good deal for young or old, wealthy or not. If you have worked for your money, dividend reinvestment programs are a great, inexpensive, and safe way to have your money work for you.

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