Roger Conrad's

DIVIDEND POWERHOUSES

Top Stocks for Sustainable Income

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INCOME-SEEKING INVESTORS looking to build wealth over the long haul are at risk of making two major mistakes: Overpaying for popular dividend-paying fare or seeking out the highest yielders without considering the underlying business risk. Maintaining discipline and adhering to the buy targets in CT Premium will be critical to outperforming in a slow-growth environment that's dominated by sector rotation.

Roger's Three Rules to Invest By

We kept three rules in mind while deciding which stock to include in the *Capitalist Times'* Lifelong Income Portfolio.

RULE NO. 1: Don't chase any stock beyond its fair value, including our favorites.

Yield is the time-tested measure of value for dividend-paying equities. To estimate a stock's expected return, we combine this metric with our best projection of annual dividend growth. A stock with a yield of 5 percent and annual dividend growth of 5 percent, for example, would have an expected return of 10 percent.

Over time, a dividend-paying stock's price will track its quarterly payout. Rapid price appreciation may outpace underlying dividend growth for months or years–but sooner or later, stock prices and expected returns almost always come back into balance. Overpaying for income-oriented stocks not only locks in a lower yield but also likely ensures capital losses when the stock pulls back.

The safest dividend payers should have an expected return of at least 10 percent. Under this system, riskier fare requires a higher return hurdle. If a particular stock doesn't meet our criteria, we'll hold out for a lower price. Patience is a virtue when you're investing for the long haul.

RULE NO. 2: Focus your buying power on quality names that have largely sat out the recent rally.

Stock prices don't always reflect an investment's true risk or likely returns; more often than not, valuations track market sentiment, which is based on a combination of facts and emotions. The trick is to know when the prevailing attitude toward a stock overestimates the potential risks or ignores the potential rewards.

Among dividend-paying groups, you can find value in MLPs and utilities names that have sat out the recent rally, former Canadian income trusts, and companies involved in the global mining complex and the telecommunications space.

RULE NO. 3: Manage risk through diversification and balance.

The conventional wisdom on Wall Street is to let your winners run and cut your losses short. This old saw is excellent advice for traders. But it's a lousy strategy for anyone living off their investment income or trying to build a portfolio for the long haul.

Letting your winners run ensures that a handful of big gainers will account for an outsized portion of your overall portfolio. Regularly taking some profits off the table in stocks that have run up to frothy levels will limit the potential damage that comes when quarterly results fail to meet the market's lofty expectations. With many dividend-paying stocks priced for perfection, expect an uptick in selloffs related to disappointing results.

Maintaining a diversified portfolio that includes exposure to a variety of sectors and avoids overconcentration in individual names helps to insulate your nest egg against weakness in a particular market segment or stock. We can't emphasize enough the importance of taking a partial profit on any big winners and keeping some powder dry for opportunistic buys.

The Founding Four

No. 1: Entergy Corp (NYSE: ETR)

Entergy Corp's stock has lagged other US electric utilities, in part because of concerns about its wholesale-power business. The sharp declines in electricity and natural-gas prices since mid-2008 have taken their toll on the profitability of the firm's unregulated systems, as contracts and hedges locking in higher sales prices have expired.

Management also continues to battle with regulators and politicians in Vermont and New York over licenses to operate its nuclear reactors.

New York state has yet to grant Entergy the necessary environmental permits for the Nuclear Regulatory Commission (NRC) to renew the Indian Point nuclear power plant's operating license. Although public opposition to Indian Point runs high in the Empire State, permanently shuttering the facility would dramatically increase air pollution in the New York City area and expose consumers to a potential increase in the price of natural gas.

By law, Entergy can continue to operate Indian Point while the NRC deliberates. But until state authorities issue the requisite environmental permits, the nuclear power plant's future hangs in limbo.

The uncertainty surrounding the company's Vermont Yankee nuclear plant is another dark cloud hovering over the stock. The NRC granted the facility a 20-year license extension, but the state government has contested the decision in court. Until this challenge is resolved, Entergy's share price will likely lag its peers.

Still, investors shouldn't let these regulatory issues scare them away from the stock; the company generates enough earnings from regulated systems in Arkansas, Louisiana, Mississippi, Texas and New Orleans to more than cover its dividend.

Investors shouldn't expect Entergy to raise its quarterly payout until the uncertainty surrounding its nuclear power plants in the North is resolved. In the meantime, the planned spin-off of regulated transmission operations and subsequent merger of these assets with ITC Holdings (NYSE: ITC) could generate a windfall gain of $10 to $12 per share.

› Consult the CT Premium for our most recent buy target on Entergy Corp.

No. 2: BHP Billiton (ASX: BHP, NYSE: BHP)

The world's largest mining company, Australia-based BHP Billiton is the low-cost producer of innumerable vital resources. Nevertheless, despite the firm's bulletproof balance sheet and dominance of key product categories, the stock is down significantly from the high reached in April 2011.

This dramatic swoon reflects a combination of slumping commodity prices, rising operating costs and about USD14 billion worth of asset writedowns over the past six years. The majority of these charges stem from a series of aggressive acquisitions that have yet to pan out in the current pricing environment.

But investors who focus on BHP Billiton's past missteps forget that the company can afford to take the long view on its investments–a luxury that smaller operators simply can't afford. Although slowing economic growth in China represents a near-term challenge, Mainland demand for vital resources will grow over the long haul as the nation's urbanization and industrialization process continues apace.

By virtue of its diversified resource base and proximity to Asia, BHP Billiton is well-positioned to benefit from this long-term trend. Investors also shouldn't underestimate the copious amounts of cash flow generated by the mining giant's operations; despite management's focus on reducing costs, another dividend hike appears likely in August 2013.

› **Consult CT Premium for our most recent buy target on BHP Billiton.** The stock is suitable for investors who don't mind taking the long view–and collecting a reliable dividend along the way.

No. 3: Dundee Real Estate Investment Trust (TSX: D-U, OTC: DRETF)

Shares of Dundee Real Estate Investment Trust (REIT), which owns high-quality office properties and pays a monthly dividend, have pulled back amid concerns about Canada's economic growth, propelling the yield to more than 6 percent–a level that's almost twice that of similar US-traded REITs.

The stock's weakness belies Dundee REIT's strong first-quarter results and 2 percent increase to the payout covering April 2013. Not only did the company grow its funds from operations by 6 percent in the first three months of the year, but the firm also completed CAD459.5 million worth of acquisitions and maintained an occupancy rate of 94.7 percent.

Dundee REIT's below-market rents and reduced debt load provide a degree of protection against any downturn and set the stage for future cash flow and distribution growth.

We also like the diversification of the firm's real estate portfolio and focus on prime locations in major cities.

› **Consult CT Premium for our most recent buy target on Dundee REIT.**

No. 4: Consolidated Communications (NSDQ: CNSL)

Consolidated Communications boasts the rare distinction of having never cut its divided during its existence as a publicly traded company–an impressive feat given the headwinds facing operators of traditional wireline networks.

The rural local-exchange carrier derives its strength from its broadband business, which accounts for about 74 percent of the firm's revenue–compared to less than half for most of its peers, which depend heavily on the declining wireline business. Equally important, federal subsidies represent only 5 percent of the Consolidated Communications' sales. The company has also kept losses in its landline business well below industry averages.

Abundant free cash flow has enabled Consolidated Communications to reduce its debt-to-cash flow ratio (a widely watched metric) to 4.25-to-1. Synergies from last year's merger with SureWest are also running well ahead of schedule.

With no debt maturities until 2017, management aims to reduce its target ratio for debt-to-cash flow to the neighborhood of 3.5-to-1. Reaching this goal hinges on the success of its broadband business, which faces potential competition from cable companies and Google (NSDQ: GOOG).

› **Consult the CT Premium for our most recent buy target on Consolidated Communications**.