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Hello and welcome to the Dividend Cafe. I am excited today to talk to you about something that I think is sort of vocabulary oriented and math oriented, but ultimately, investment oriented. I want to use the opportunity to clarify what we mean when we talk about certain things as investors and allow you to extract from that an actual investment takeaway and investment understanding that I think is at the root of our philosophy of dividend growth investing. There's a lot of talk about yield, "Hey, I want to get a higher yield". And what do people mean by that? Well, yield is of course the income and investment is producing divided by the value. And so if you put out a $100,000 and you're getting $4,000, then you have a 4% yield. And yet if that 4% is still coming and yet the $100,000 could be sold for $200,000, now you have a 2% yield, right? You're still getting $4,000, but it's now divided by $200,000. And so yield is really a very deceiving term because it has efficacy or relevance or import at the point of a purchase. And it could be a factor at the point of a sale, but it is a descriptive term that is simply a byproduct of math. It's an equation. It is an income divided by a current value. And so when someone says, "Oh, the yield is going down", do they mean the math of my income divided by my investment? Or do they mean the income is going down? If they mean the income is going down, they could have a problem with the investment and if it were the way we invest money, it would be a problem because we are investing for growing income, not declining income. And so if they're simply using the wrong term, that's one problem, then we just have to correct nomenclature, correct vocabulary. No, the yields, the income's not going down. The yield is a different story. We can figure out what they mean. If they mean though that yes, the yield's going down, then we have to look at something we don't yet know, what is the income doing and what is the value of the investment doing?

And so I had had a couple people reach out and say, well, I know you mentioned that the income is growing x percent a year, but I look at the yield year by year. It doesn't look like it's doing that. And immediately I understand that there's a little bit maybe a misunderstanding about basic financial vernacular and maybe even the need to help with some math on things. And so I thought, well, if a couple people have this question, more than a couple people have this question. And so here we are, I want you to imagine that scenario, but now I'm gonna change some inputs. You have a hundred thousand dollars investment and five years later it's still a hundred thousand and yet the 40,000 is now 60. So the income is up by 50%, it went from 40 to 60. And so you have a 50% increase in the income, but the value itself has not gone higher. And so in that case, the yield went from 4% to 6%. Are we happy about that? Well, you know may say yes because I got the growing income. You may say no, because I didn't get a growing value. But the math of the fact is that the yield went higher. Now what if I said that you put in a hundred thousand, you're getting 4,000 and now two years later it's worth 50,000 and you're still getting the 4,000. So now what is the yield? You're getting 4,000 divided by 50, you have an 8% yield, but you're down 50%. Who in their right mind thinks that's the way you want to get a higher yield by losing value substantially without any growth of income.

Now, more realistically, a lot of people would like to avoid investments that are going down 50% and the idea of an investment maintaining its yield and dropping 50% can happen, but it's certainly not super common, at least not without per the risk of a pending dividend cut. But let's say we're talking about a situation where just to do some basic math for you and in Dividend Cafe.com today I walk through and I actually put the little charts for you homemade by me. Three or four different scenarios of here's the value, here's the income, and year by year here's

the ending and what it means to the yield. And let's say that the stock has years, it's up and down, but the investment, the income is growing 6% per year, but the stock price ends up averaging 9% a year. Okay? So maybe one year is up 15, one year it's down three. But by when all said and done, you average nine and your income has grown 6% a year, is the yield gonna be higher or lower? Okay, by definition the yield's gonna be lower because the denominator in value is higher than the growth of the numerator, which is the income. So this is just math. The yield went lower even as the income went up really nicely. And in fact, whether that's the primary motive or not, the value went higher as well. See for us, the primary motive is the growth of that income. And you go, well, don't you want the value to go higher? I go, yes, yes, of course, but I already know that's gonna happen. I don't think about that. I don't have to worry about that because what drives the value going higher? Sentiment, momentum, a higher PE ratio at a point in time, those things are gonna move it at different points in time and they're all out of my control and they're all unpredictable and they're all fundamentally irrelevant. But if the cash flows are growing and a company is in the state of mind and in the general practice of growing the dividend from their cash flows that they're paying to investors, then that can become my focal point. I can focus on those things that are researchable, that are analyzable.

So the idea that someone would be upset that they're getting six and a half percent growth from their dividends and that the stock itself is growing more than that is insane. They're getting more of an exit value if they were to sell and they're getting a very nice compounding of what's happening within the cash flow, the growth of the income, but yet the math of the yield would be lower. So the only way to keep the yield the same and have the income grow every year is if the stock price and the income are growing at the exact same amount. If you accept as a law of

nature that is simply not gonna happen, then you're just going to have periods where the yield is either higher or lower than what it started at. And if let's say the stock price grows at 6% a year, which is pretty good and the income grows at 8% per year, which is really good, then you're gonna actually have your yield itself growing. But that is not the objective, it's the income. The yield is just a byproduct of the math of two variables. So the reason I bring this up is not just to educate people on math and vocabulary and what these terms mean, but it's to reinforce the point all the investors should ever be talking about is the income. Because if their income's going higher, then their investment is theoretically doing what they want it to do, either because they're compounding that income into more shares that produce the income or because they're withdrawing that growing flow of income. So income is dollars, yield is the math of dollars divided by value at a point in time. And you could see why. What is material or practical or actionable are dollars and in other words, income, not percentages.

Okay, now you say, all right, well that's good enough, but I still like to have a way to express it. This is where this expression, and maybe you don't think it's as simple or succinct or useful as I do, but many years ago my friends at Miller Howard Investments in Woodstock, New York, coded the term 'YOI' yield on original investment. And that to me is the fundamental marker of what an investment is doing. What you want it doing is what the income you are getting now is divided by the value at the point you bought it. And this is where the simple math, not the miracle stock selection, not the miracle portfolio management, but just math can become somewhat wondrous to behold. The examples of companies that were paying a certain dividend and over a period of time compounded that dividend and the stock price could be up or down relative to the rate of growth of the dividend. And yet the income now divided by the stock price then may be 100% that each year the cash on

cash return could be that dramatic. Now that takes a lot of time to get to that level. Some of the great blue chip companies that are aristocratic dividend growers, you're talking about stocks that maybe from the early '90s or mid '80s, that's where you're getting to the hundred percent YOI yield on original investment now, if they've been a consistent dividend grow over that time, but even companies that have been growing the dividend for 20 years, not 30 or 40, you may have a very high cash on cash return, but you go, well, I don't get it. I looked, it says the yield's 3% or two and a half percent. Well, markets aren't stupid. That income growing like this causes the stock price to go higher. And so the current yield looks lower because that income that's growing, growing, growing divided by the current stock price is a lower yield. But what really captures the majesty of the wealth creation and the investment merit dividing the income that you get now from what you invested in the asset. And I think people intuitively understand this about real estate investments and yet totally missed the boat on this when it comes to stocks.

So we are looking for a YOI, a yield on original investment if we want a real measurement. So then you could have a company that look at the example I put in Dividend Cafe.com. They're growing the dividend 6% a year. The stock's growing 8% a year. Your yield may have gone from 4% to 3.4%, but after six years your yield on original investment might be 6%. In other words, it's grown quite a bit in a few years, even though the current yield is lower, it all comes down to the math of how you're viewing it. And so for those who just need a more succinct understanding, what's more succinct than the income? The income growth and expressing that divided by what you paid for the investment. And yeah, if you're just so upset that the investment grew in value and so the math of it means there's a lower current yield, then you know can really mourn that awful event of an investment going up in value.

But I think you see my point, so this is a little math, little vocabulary and hopefully a good investment takeaway. We invest as dividend growth investors for the purpose of compounding the growth of income that comes from good cash flow generative investments. We believe companies that do that are more inclined to properly run their business and align the interest of management with shareholders. They make less mistakes. And in all cases, none of this is infallible, but we are looking to reduce risk, to mitigate risk, to not be constantly compounding that point of risk without compounding our return. And this is therefore why a return of cash to shareholders in the form of growing income that yes results in the yield, but fundamentally results in more money in the pocket of investors either for present or future needs. This is what I do all day, this is my life, is what I signed up for. This is what I love. And I hope you understand it just a little bit better than you did 15 minutes ago. Thank you for listening to and watching the Dividend Cafe and we look forward to coming to you on Wednesday of next week with a very short Thanksgiving reflection. Always appreciate you watching the Dividend Cafe.

Due to the publishing time constraints for us to produce our daily missive, podcast, and video, the best we can offer at this time is a machine-generated transcription which contains errors. We will continue to work to improve this service and appreciate your patience with us.