



Process for Selecting High Dividend Stocks

July 15, 2023

When I advocate high dividend stocks (greater than 8%) as a significant part of an investor's allocation, some of you may be interested in knowing how to go about selecting, buying, tracking and selling. Others may be interested in having me do it, which we could explore. Whether you do it or I do it, what follows is a rather detailed outline of the investment process. I believe successful investing requires a defined business process.

Allocation

The first step in any top-down investing is to determine the desired allocation. For that process I recommend an Excel template found at WenzelAnalytics.com/Planning. One template has formulas that start with percentages for each allocation category and gives the corresponding dollars. The other table starts with dollars for each allocation category and reveals the corresponding percentages. The expected returns for each allocation (category of your choosing) has one column for the expected income and another column for the expected gains from price appreciation. (We never expect a loss.) I find this separation between income and price variation to be critical in evaluating an overall allocation. The next column is what I call a volatility factor or discount. For every investment there are risks that expectations will not be met. While this can be stated in terms of odds, standard deviation, Sharp Ratios, Coefficient of Variation or other metrics, I find the most intuitive metric to be multiplying a simple percentage discount to expected returns. The income plus the gains times the discount factor times the allocation percentage gives an adjusted expected return for that allocation. These can be summed for all allocations to get an expected return for the included assets. The allocation exercise may be only for brokerage assets or include all investments.

As context, I would remind the reader that over the past 95 years, the compound annual growth rate for the S&P 500 is 9.66%. An analysis of the volatility involved, supporting a discount value in our allocation template, is provided in my paper *Comparing Gains to Income, Converting Yields to Returns* at WenzelAnalytics.com/Papers/Methodology. For the next year, the 900 preferred positions under Wenzel Analytics management have an income compound annual growth rate of 12.1%. (See Performance Summary, Second Quarter.) The 12.1% is without the unknowns of stock market price volatility. In addition, the current median price is \$20.07 meaning there will be a 25% gain if held until call of \$25, although we don't know when that call might occur. My question is "How extreme should our outsized allocation be for preferred stocks?"

I divide high dividend stocks into preferred stocks and high-income growth stocks. (Preferred stocks are actually debt instruments rather than stocks having equity and company ownership.) The preferred stocks I further divide into portfolios for notes (identical to preferreds except there is a fixed maturity date), REIT preferreds and other preferred stocks. The high-income growth stocks are divided into portfolios for REITs and other high-income stocks. The other high-income stocks are mostly Business Development Corporations (BDCs) and Closed End Funds (CEFs).

Both the preferreds and the high-income growth stocks derive their income from debt. With the preferreds and similar notes, we own the debt. With the high-income growth stocks we own companies that own and manage the debt. The primary difference between preferreds and other high-income portfolios is that with preferreds we know an eventual call price, which limits the market volatility. With the REITs, BDCs and CEFs the eventual sale price is not known.

An alternative to mutual funds.

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Buying (and Selling) Preferred Stocks

I will first describe in some detail the process for selecting preferred stocks, then move on to selecting other high-dividend (growth?) stocks.

The best data source I have found is CDx3 at CDx3investor.com. It was originally developed and managed by Doug Le Duc and later sold when he developed health issues. His very thorough free book on preferred stocks is free in a pdf format. He found ten criteria that predict the most reliable returns, giving each stock a score for how many criteria are met. These are factors such as cumulative dividends, industrial ratings, PAR value of \$25, and being domestic. In addition the site has charts and descriptions as to current trends in preferred stocks and averages relative to other benchmarks (thus the CDx3). The database has about 1,500 stocks. The service is available to original subscribers for \$16.50 per month.

While one can search, sort and view various lists on the CDx3 website, I export csv files for stocks with scores of 10, 9 and 8. Using sorts and lookups, these are consolidated into a single file without duplicates. Fields (columns) are then added to this Excel file and I begin the process of sorting, culling and cleaning the data. I do an Excel Lookup from the previous file for some of the data requiring individual editing, such as the abbreviated name, notes or listing by High Dividend Opportunities.

The fields used, the source of the data and a description of each field or criterion is given in the table below. Since the price and volume automatically update, I find that doing a new sort by Current Yield each day I'm buying works for a month or two after which I construct a new file and find that it gives new positions. For me it takes several hours to build a new buying worksheet.

Columns (Fields)	Source	Description
Qualifier	Worked	In the setup or construction process, positions are eliminated and sent to the bottom for various reasons identified here, but may be retrieved later. Examples include duplicate position by same corporataion (common stock), technical evaluation of common stock chart, technical analysis of preferred stock, low F-Score, low trading volume, low grades by Navellier Grades, Over the Counter (sell only), non-cumulative, current yield < 8%, price < \$12.50, price > \$25.20. Of the 609 positions in the current download from CDx3 meeting 8 or more of the CDx3 criteria, 32 are on the buy list. The rest were disqualified by the above criteria.
CDx3 Symbol	CDx3	Hidden except for setup
TC 2000 Symbol	Excel Replace	Hidden except for setup
Yahoo Symbol	Excel Replace	Hidden except for setup
Owned Paste Portfolio	Pivot of Owned from Master file	These are pasted from a pivot table of owned positions to see what positions are already owned.
Owned Paste Common	Pivot of Owned from Master file	This field brings in the common stock symbol to see if another preferred by the same company is already held.
Owned Paste Symbol	Pivot of Owned from Master file	This brings in the symbols of what the client already owns.
Amt Owned	Pivot of Owned	We may want to add to a current position.
Common	Worked	Ticker symbol of the common stock
IB Symbol	Excel Replace	Ticker symbol of the preferred stock (Interactive Brokers format)
Abbr Name	Worked	The CDx3 names need to be abbreviated to fit my reporting formats and avoid columns too wide.
Portfolio	Worked	I divide preferred stocks into Notes, Preferreds of REITS and other Preferreds.
Call Date	CDx3	
Callable	Excel formula	
Not Owned Common	Excel Lookups	Does a lookup to the pasted common stock to indicate if the buy list stock is already owned.
Not Owned LkUp	Excel Lookups	Does a lookup to the pasted preferred stock to indicate if the buy list stock is already owned.

Columns (Fields)	Source	Description
TA Com	TC2000	Technical Analysis of the common stock. This is a primary evaluation tool.
TA Pref	TC2000	Technical Analysis of the preferred stock.
Navellier Total	Navellier Grades	These grades are used to avoid bankruptcy positions. F's are dropped and most D's.
Navellier Quantitative	Navellier Grades	These grades are used to avoid bankruptcy positions. F's are dropped and most D's.
Navellier Qualitative	Navellier Grades	These grades are used to avoid bankruptcy positions. F's are dropped and most D's.
F-Score	Stock Investor Pro	F-Scores below 4 point to weak fundamentals.
Notes	Worked	I note anything unusual about the position, such as if it is foreign.
CY Calc	Excel formula	Current Yield calculation. In the selection process, this column is sorted descending.
YTC-Calc	Excel formula	Yield to Call calculation. If callable, CDx3 leaves this blank. I calculate it to if called today.
Score	CDx3	CDx3 has 10 criteria found to work best. The score is not on the import, but one can import files for those with 8, 9 and 10 which are then consolidated. Those with an 8 are only in the 8 file, 9's are in the 8 & 9 files, 10's are in all 3.
Status	CDx3	Taxable as Qualified Dividends or not.
Last Price Yahoo	XLQ	XLQ is an Excel addon that gives current prices.
Avg Vol Yahoo	XLQ	CDx3 gives a daily volume. A three month average is more reliable.
F/F Div+ Liber or SOHO	Prospectus	For stocks with Fixed/Float (dividend can change when callable), the new rate is specified in the Prospectus as a percent above the Liber or SOHO rates. Fixed Float is a protection against high inflation (and a risk if inflation drops).
Own	Excel Lookups	Is this position already held in someone's account?
HDO	High Dividend Opportunities	The Rida Morwa newsletter (Seeking Alpha) runs in-depth reviews of some preferreds that are particularly helpful for positions I wouldn't otherwise buy.
Last Price CDx3	CDx3	Since this price is static, I hide this column.
Yield-CY	CDx3	Since this price is static, I hide this column.
Yield-YTC	CDx3	Since this price is static, I hide this column.
Yield-EAR	CDx3	Since this price is static, I hide this column.
Volume	CDx3	Since this price is static, I hide this column.
Div Rate	CDx3	Used in calculating yields.
IPO Date	CDx3	
Ex-Div Date	CDx3	I don't pay much attention to this.
Maturity Date	CDx3	This is relevant for notes (Baby Bonds)
Liquid Price	CDx3	PAR, \$25. PAR of \$25 is one of the 10 criteria for CDx3. I rarely buy another PAR.
Moody's	CDx3	Holding out for investment grade cuts the dividends dramatically. I prefer other measures of quality. It is more relevant for institutional buyers. If volume is high enough for institutional buyers, I've lost my competitive advantage. It's expensive for the offering company.
S&P	CDx3	
Exchange	CDx3	
Prospectus	CDx3	These links are handy, especially for looking up fixed float parameters.
Investment	CDx3	This is the name used by CDx3 which I abbreviate (above).

When buying, I paste from a pivot table taken from the Master file of all positions held. This paste inserts what positions are already held in that client's accounts, or a position is already held by the same

company (same common symbol). Excel Lookups automatically flag symbols on the buy list which are already held, and the amount. (I may choose to add.)

Managing and Reporting on Preferred Stocks

It is important to monitor preferred stocks for when they trade above Par of \$25 and they would have a loss if called. Some preferreds have dividends high enough to justify a possible loss upon sale. If it has been trading above Par for several years after the call date, the chances of it being called are not great. I have a formula in Excel that comes up yellow and then red when the Yield to Call drops below 6% and then 4%.

The other risk is that of prices falling, pointing to deferred dividends or even bankruptcy. The best way to monitor this risk is to watch for the common stocks dropping in price more than the market or its industry benchmarks. A drop in the price of the common stocks signals a risk for the preferred, although sometimes the preferred will maintain its price. Sometimes the price of the common will drop down below \$3, and even below \$1 with their preferred in the \$3 range and stay that way for a long time. Typically, if a common stock is dropping more than benchmarks, it signals risk and time to look into the situation, maybe to sell. Evaluating a common stock for bankruptcy is very different than evaluating for price appreciation. If a company is well capitalized it can often withstand temporary challenges, such as malls losing anchor tenants and a loss of rents until a more entertainment or experience-based tenant takes its place. Playing such high-risk situations is a different game. I try to balance high-risk and low-risk positions in a portfolio.

Unrealized returns have a built-in compounding factor lacking for dividend rates. To get a yield calculation comparable to return calculations, it is necessary to do compounding on the dividends. Since dividends are usually aggregated and invested in the most attractive preferred stocks at the time, the compounding is hypothetical rather than done through reinvested dividends. This process accounts for some of the fields tracked for managing and reporting in the table below. You may not find it relevant, as it may be more of an occasional research project than part of ongoing reporting.

The following data are maintained for each position in the Master file. The Master file is used as a trading worksheet to determine how much to buy and other order information. The file has historical information (replaced each year) and information useful in monitoring and reporting.

Master File

Col	Column Head (Field)	Excel Formula Example	Use
A	Client	Columns A-F are pasted from worksheet of accounts	Household
B	Tax	i.e. IRA, Roth, Post, Trust	Tax
C	Own	=IF(Q3<1, "Own", "Sold")	To sort sold positions to bottom
D	Custodian		Custodian or broker
E	Account		Account number at broker; Often multiple accounts per client
F	Owner		Owner (Title at broker)
G	Yahoo Sym		Yahoo Symbol used for realtime price and volume
H	Common		Common stock symbol
I	Symbol		Symbol used by broker
J	Investment Name		Investment Name
K	Inv Type		Inv Type
L	Goal		Goal
M	Portfolio		Portfolio
N	Inception Date		Inception Date
O	Days Held	=\$A\$2-NRow [Today()-Inception]	Days Held

Col	Column Head (Field)	Excel Formula Example	Use
P	Basis		Original Cost
Q	SoldDate		SoldDate
R	Action		Notes, i.e. buy, sell, lmt ord, sell after...
S	Shares		Shares
T	Buy-p	=xlqprice(I row)	Gives price when buying; Enter buy price to calculate cost
U	Commission		Commission
V	Trial Cost	=(T Row*S Row)+U Row	When buying, to balance orders against cash available
W	Cash	=SUMIFS(\$P\$2:\$P\$101,\$E\$2:\$E\$101,E Row,\$K\$2:\$K\$101,"Cash")	When buying, shows cash in account
X	Cmpd Client	=A Row&I Row	When buying, to check if client already owns stock
Y	Dup	=Y Row=VLOOKUP(X Row,X\$86:X\$1553,1,FALSE)	When buying, to check if client already owns stock
Z	Price	=VLOOKUP(I Row,prices.xlsx!prices!\$A\$1:\$B\$299,2,FALSE)	Reconciles to closing brokerage price
AA	CurVal	=IF(Q Row>1,"",Z Row*S Row)	Current valuation
AB	Client%	=IF(AA Row="", "", AA Row/SUMIF(\$A\$3:\$A\$2531,A Row,\$AA\$3:\$AA\$2531))	Position as percent of total for client
AC	Gain/ Loss	=IF(AA Row="", "", AA Row-P Row)	Unrealized gain or loss since purchase
AD	QDI	From CDx3	Qualified Dividend Income; Preferreds get capital gains rates
AE	Annual Return	=365/(\$A\$2[Today()]-N Row)*AC Row/P Row	Annual return based on price (not income)
AF	Call Date	Pasted from preferred buy list	For bonds, preferred stocks and notes
AG	DivRate CDx3	Pasted from preferred buy list	Dividend Rate
AH	Yld on Cost	=AN Row/P Row	Yield on Cost
AI	Curr Yld	=(AG Row*25)/Z Row	Current Yield based on today's price
AJ	Curr YtoCall	=AI Row+ IF(AF Row>\$A\$2[today()],((25/Z Row-1))/((AF Row-\$A\$2[today()]/365.25)),(25/Z Row-1))	Current Yield to Call (If callable, Yield to Today)
AK	HDO		High Dividend Opportunities has write-up
AL	Vol \$AVg3m	=xlqAverageVolume(G Row,"Yahoo")	Average daily volume past three months
AM	Fix/Float	Imported from buy list for preferreds stocks or found in Prospectus	Preferred rate when callable may go to prescribed amount above Libor or SOHO.
AN	Annual Div \$	=AG Row*S Row*25	Preferred dividend dollars per year
AO	Fractional Years	=O Row/365.25	Days held as a fraction of a year; used to calculate yields
AP	Accr YoC Value	=P Row+(AN Row*AO Row)	Accrued Yield on Cost Value (Basis plus accrued income to date)
AQ	Accrued Reinv Val	=IF(AP Row<1,\$P Row+(\$AN Row*AP Row),POWER((\$AH Row+1),(\$AO Row)*\$P Row))	Accrued Value if dividends compounded (reinvested in same position at same price)
AR	Accr Reinv Val Next Yr	=POWER((\$AH Row+1),(\$AO Row+1))*\$P Row	Accrued Value in 1 year if dividends compounded (geometric return)
AS	Yield Next Yr	=(AR Row-AQ Row)	Yield next year in dollars
AT	Diff from Div Next Yr	=(AS Row-AN Row)/AN Row	Forward yield from compounding (hypotheical reinvesting, same price and position)
AU	CAGR Next Yr	=AS Row/P Row	Compound Annual Growth Rate for next year

Buying Other High-Dividend Stocks

I rely almost exclusively on the newsletter High Dividend Opportunities written by Rida Morwa and published by Seeking Alpha for buying recommendations for the other high-dividend stocks described

above under Allocation. In addition to a buy list, each week he publishes a list of five or six highly recommended positions, along with an analysis and rationale for each justifying the recommendation and yield. I see myself as in an information chain, with Morwa using primary sources, I use Morwa, and clients derive value from my assimilation of the information.

Each week or so as I read the recommendations and details, I add a column in front of a list of stocks. In the new dated column I enter if it was a first choice, second choice, etc. I then sort the rows by rank. Looking to the left I can see previous rankings for any position. I have a column for yields, date reviewed, and a column describing the stock and anything significant.

The volatility of price plus dividends tends to track the market fairly closely in down markets and exceed in up markets. The difference is that we have the dividends to reinvest or redeploy, which we don't have with unrealized gains. Last quarter the dividends were at a 13.1% annual yield. Over all accounts, we have a 23% allocation in these high dividend stocks and 60% in preferred stocks.

Sell recommendations, and consequent sales, are rare.

Conclusion

I've tried to be specific with the details of one way to manage high dividend (>8%) stocks. It may be more in the weeds than anyone else is interested in reading, as we tend to each develop our own systems. Maybe you can use a feature or datapoint or two. If for no other purpose, it is a good exercise to document one's business process and good to have it documented.