How to avoid dividend cuts

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It’s not just the loss of income, it’s the loss of principal and when you think about it, if I impede my principal, I also impede my ability to generate income.

We look at cash flow from operations first. Dividends have to be paid out of current or retained earnings so -- what is important is the health of the earnings of the corporation, the health of the cash flow. Second thing you can look at is dividend cuts are often tied to credit reviews, where the rating agencies, S&P and Moody’s, are starting to question their ability to pay back that debt and is threatening them with some type of credit review. What is very easy for the corporation to get back to them is this cash outflow called the dividend so what they’re trying to do is protect the bondholders, not the equity holders. The last thing that you can pay attention to is price volatility. When the stock is highly volatile on the way down, that’s probably signaling something to you and you should at least be aware of it. It’s a combination of three things. It really is cashflow coverage of the dividend; it is the health of the balance sheet, so is the company getting into trouble with debt; and the last thing is if you have the first two and you see the stock get highly volatile, you should pay attention.
