

# Dogs of the Dow

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In his 1991 book *Beating the Dow*, Michael O'Higgins popularized a simple strategy for outperforming the Dow Jones industrial average over the long haul. The system, known as "Dogs of the Dow," calls for annually investing equal dollar amounts in the ten Dow stocks with the highest yields. The portfolio is rebalanced with a new pack of "dogs" using the last day's close of the year.

The Dogs of the Dow strategy has outperformed (total return) the broader index in three of the last five years.

Why the success? It pays to be contrarian in stock investing, especially when dealing with pedigree companies like the Dow industrials. These blue chips may run into trouble, but they stand a decent chance of rebounding along with the value of their shares.

Altria Group proved the point in 2005. The company enjoyed improvements in pricing and market share, as well as encouraging news on tobacco litigation. Its market value increased 22% for the year. At the start of 2005, Altria had a yield of 4.8%, enough to qualify it for one of the ten highest-yield Dow stocks.

Despite the rally, Altria's yield, now down to 4.3%, still wins it a spot on the 2006 Dogs. But the standout hound these days is General Motors, whose shares declined 52% in 2005. GM's stock currently yields 10.3%, which in itself is a strong signal that the annual dividend of \$2 per share is in jeopardy.

Even if GM eliminates or reduces its dividend, the stock could still make a positive contribution to the 2006 Dogs of the Dow portfolio listed below. GM's management recently announced a plan to cut 30,000 workers and close 12 plants by 2008. It also won concessions from the United Auto Workers on health care costs.

Analysts reporting to Thomson IBES expect GM to show a loss of \$4.17 per share for 2005, versus a \$4.95 profit in 2004. But the consensus calls for GM to earn 92 cents and \$2.89 per share in 2006 and 2007, respectively.

The first table below shows the annual performance of the ten Dogs of the Dow from 2005. The second table lists the 2006 Dogs of the Dow.

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## 2005 Dogs of The Dow

Company	Price 12/31/2004	Yield 12/31/2004	Price 12/31/2005	Yield 12/31/2005	Total return*
Altria Group	\$61.10	4.8%	\$74.72	4.3%	27.7%
Citigroup	48.18	3.3	48.53	3.6	4.6
duPont (EI) deNe-mours	49.05	2.9	42.50	3.5	-10.5
General Electric	36.50	2.4	35.05	2.9	-1.4
General Motors	40.06	5.0	19.42	10.3	-48.4
JP Morgan Chase	39.01	3.5	39.69	3.4	5.7
Merck	32.14	4.7	31.81	4.8	4.0
Pfizer	26.89	2.8	23.32	4.1	-10.6
SBC Communica-tions**	25.77	5.0	24.49	5.4	0.2
Verizon Commu-nications	40.51	3.8	30.12	5.4	-22.2
<b>Dogs of the Dow average total return: -7.8%</b>					
					<b>DJIA: 1.7</b>

DJIA: Dow Jones Industrial Average

\*Total returns calculated from 12/31/04 thru 12/30/05

\*\*Company and ticker are prior to merger with AT&T

Source: FT Interactive Data via FactSet Research Systems



## 2006 Dogs of The Dow

Company	Price 12/30/2005	Yield 12/30/2005
Altria Group	\$74.72	4.3%
AT&T	24.49	5.4
Citigroup	48.53	3.6
duPont (EI) deNemours	42.5	3.5
General Electric	35.05	2.9
General Motors	19.42	10.3
JP Morgan Chase	39.69	3.4
Merck	31.81	4.8
Pfizer	.32	4.1
Verizon Communications	30.12	5.4

Source: FT Interactive Data via FactSet Research Systems