

# FINANCIAL TIMES

MARCH 7, 2008

## Sit Back and Just Let the Dogs Do All the Work

*By Peter Temple*

For anyone looking for a lazy way of outperforming the market, there is an easy yardstick. And it seems to work consistently well. At FT Money, we call it the "Dogs of the FT 30".

For each the past five years, we have looked at how the well-known Michael O'Higgins "Dogs of the Dow" share selection system would work when applied to the UK market. This past year the system has again outperformed the market, although it showed a small fall overall.

To recap on what's involved we need to go back 1991. Back then, O'Higgins, a US fund manager, outlined a simple approach to dividend-based investing in his book *Beating the Dow*. It has subsequently been updated. He reckons that shares selected according to his system had produced an average annual performance five percentage points better than the Dow Jones over the period from 1961 to 1995, provided dividend income was included in the calculation.

As we seem to have proved, it works for other markets that have an index with similar characteristics, such as the UK's FT 30. It doesn't work every year, but over time its results are impressive. In the case of the UK it has outperformed, sometimes spectacularly, four years out of the past five.

The idea is simple. Get a list of the 30 stocks in the index. There is background to the FT 30 index, and a list of constituents in the market data section of FT.com. Once you have the list, take the 10 highest-yielding stocks. Looking at these 10, invest equal amounts in the five stocks with the lowest share price. Leave well alone for a year. On the first anniversary of your selection, review the list again. Reinvest the portfolio plus the accumulated dividend income in the new selections. On the second anniversary, do the same. And so on.

A variant of the theory suggests you can achieve a similar performance with a single stock, by selecting the five stocks as described, but by just investing in the one with the second lowest share price. O'Higgins calls this the PPP: the "penultimate profit prospect".

The table shows how the five selections picked from the FT 30 each year for the past five performed relative to the FTSE 100 over the same period.

So, although this year was the worst absolute performance since we began looking at the "dogs" system, the five stocks selected still did better than the market and the drop in capital value over the period was offset by the dividend income an investor would have collected on the shares in question.

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Applying the O'Higgins rules to the FT 30 last year gave the following five stocks: BT, Compass, Vodafone, GKN and EMI, the latter also being the nap selection on the O'Higgins "penultimate profit prospect" rule.

The average change in the price of these five stocks in the past 12 months was - 3.6 per cent, exactly equivalent to the average yield on the five stocks at the start of the period. The best performer was Vodafone (up 10.7 per cent). This was followed by EMI, up 9.64 per cent at the time it was taken out last August 2007 by the bid from Guy Hand's Terra Firma. Compass Group rose 6.6 per cent over the period.

The average performance was spoiled by BT, down 26.5 per cent, and GKN, down around 19 per cent. The single stock selection, EMI, was the second best performer. The broad market, as represented by the FTSE 100, was down by 7.4 per cent over the period. These percentages are based on prices at the close on February 29.

This makes four years out of five that the system has worked well. The best year was the first. In the year to end-February 2004, the five stocks selected saw an average gain of 117 per cent versus the market's 24 per cent rise. And investors would also have benefited in that year from a double-figure yield. In the wake of the post-2000 bear market, those conditions were exceptional. But maybe after the recent shocks to the financial system, the coming year could be a good one too.

So what does the system say are the stocks to invest in for the coming year? There are a few changes. Using data as of February 29, the system picked ITV, BT, GKN, Logica and Royal & Sun Alliance. Logica is the single stock selection. The average yield on the group of five is 5.6 per cent (3.63 per cent last year).

As ever, the system dictates that you invest the same amount in each of these five stocks, sit back for a year, and do nothing. No tinkering or second guessing is allowed. If a stock succumbs to a bid, as EMI did last year, simply put the cash on deposit until the year is up. It's a lazy way to invest but over the past four years it has proved to be none the worse for that.