Where has all my income gone?

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For many people, one of the lasting effects of the financial crisis in 2008 has been living with the lowest UK interest rates ever.

This has meant that cash savings earn little or no interest from the banks and building societies and for many people relying on a fixed income their standard of living has fallen sharply. Factoring in the recently high level of inflation has meant negative real returns for investors and savers.

The traditional alternatives to cash deposits, particularly for the risk averse, have been National Savings, UK Government gilts or fixed interest bonds. However, the income return from these sources has been disappointing. If, as some pundits fear, UK interest rates remain lower for longer than originally anticipated then savers may need to consider assuming more risk to obtain better returns when investing their cash.

This has resulted in a growing and demographic push towards securing income. I say demographic because the "baby boomer" generation who have been spending, investing and who benefited from rising house prices for example, have now reached the point as they head into their 60's, both their priorities and risk profile are changing. They too have become "income hungry" and have joined the rest of us who are seeking a relatively safe income at a reasonable price.

Whilst pondering this thought my eye was drawn to a recent headline in one of the financial periodicals which stated that the dividends distributed by UK companies during 2011 reached an all time record of £ 67.8 billion. Total gross dividends rose 19.4% for the full year and represented the first annual increase since 2008.

Now I do recognise that dividends paid to shareholders in Stock Exchange quoted companies may not be the ideal investment medium for everyone. Equity risk, as it is known, is unlikely to suit those savers and investors who shudder at the thought that the value of their capital may go down as well as up. Recent volatility in the stock market often only serves to emphasise what are seen as the risks of investing in shares.

Nevertheless, there are a broad range of UK companies, often household names, which are currently paying attractive dividends so that the "yield" (income return) is often significantly higher than the miserly returns on cash deposits. Investing in shares isn't for everyone. However, the inclusion of a small number of core stocks or an investment into an equity based income fund, where the underlying investments are effectively managed for you, may serve to enhance your returns without excessive risk.

Dividends and dividend growth are the key drivers of equity returns over the longer term. Companies that have a track record of consistently growing their dividends typically provide stronger long term returns than those companies with more irregular dividend histories.

The extent that dividends contribute to the total return from leading companies is illustrated by the graph of the FTSE 100 Index for the ten years to the 30th December, 2011.

In terms of price (capital) appreciation, the value of the index increased by just 6.8%, however when the dividend distributions are added then the total return is 58%.This is a clear indication of the value of dividends to investors.

There is growing interest in dividends and there have been several funds launched recently to cater for investor's requirements for a dividend equity strategy as the investment industry responds to a growing demand. All the indications are that the numbers over time do stack up and make investment into direct equities or through collectives, worthy of consideration. Historically the original reason that investors bought shares was that the dividends were often much higher than the returns from bonds. A similar situation to what we find today…..a UK Government 5 year gilt yields 1% compared to mobile phone operator Vodafone which currently pays 5.2% and pharmaceutical giant GlaxoSmithKline paying 4.8%.

Equity investing will not be appropriate to every saver's aspirations, but if you think that your risk profile and circumstances are suitable and the prospect of regular dividend cheques dropping through the letter box or being credited directly to your bank account appeals to you, then you may wish to seek further advice and guidance from a reputable stockbroker or independent financial adviser.

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