The Dividend Machine

Edited by Bill Spetrino

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Achieve Financial Freedom With Secure Income And A Total Return Strategy

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CURRENT YIELD BENCHMARKS
as of June 11, 2012

YIELD		MONTH AGO	YEAR AGO
MONEY MARKET (7-DAY AVG.)	0.03%	0.03%	0.02%
3-MO. TREASURY BILL	0.07%	0.07%	0.02%
1-YR. CD	0.75%	0.76%	0.56%
10-YR. TREASURY NOTE	1.63%	1.80%	3.26%
S&P DIVIDEND YIELD	2.09%	2.01%	1.76%

How Dividend Stocks Can Turn $30,000 Into $30 Million

When it comes to providing the best opportunities for my daughter, I'm no slouch. My wife and I have prioritized and budgeted to ensure she does not want for any of the essentials — clothes, food, school supplies, some spending money to be able to go out with her friends, and a nice roof over her head. Just as any good parent would.

There's no doubt, we love her more than anything . . . but heck if I would ever have followed in the footsteps of the parents I read about recently who are jockeying to get their children enrolled in a $30,000-per-year preschool.

No, not college. *Preschool*.

Of course, the main arena for this ridiculous preschool-slot bidding war is Manhattan, where outsized wealth is only outflanked by the outsized spending on things like Fifth Avenue real estate, by-invitation-only shopping on Madison Avenue, and door-to-door town car service (complete with security detail in some cases) for private school drop-off and pickup.

The idea that someone would pay tens of thousands of dollars for their four-year-old to learn letters and finger painting certainly demonstrates that even among the rich (or especially among the rich), simple math is not a strong suit.

That's because, for the incremental elevation in educational quality — trust me, there are plenty of good preschools available where kids can learn a heck of a lot for a much smaller price tag, even in New York — those parents are giving away literally millions of dollars in potential future income.

What do I mean? Let's say that, instead of taking that $30,000 and spending it on a year's tuition for a four-year-old, you invested the money in dividend-paying stocks. Figuring a 12 percent compounded return, the money would double every six years.

So the account would be worth $60,000 at age 11, $120,000 at age 17, $240,000 at age 23, $480,000 at age 29, $960,000 at age

35, $1.92 million at 41, $3.84 million at age 47, $7.68 million at age 53 and $15.36 million at age 59.

When that child reached the "retirement" age of 65, he or she would have $30.72 million — hence the quote marks around the word retirement, because clearly this person would have the financial freedom to walk away from the workforce long before hitting that birthday milestone.

Keep in mind, this isn't investing $30,000 each and every year in perpetuity. These figures are based on a one-time investment of $30K, and then just letting it ride.

Now, that 12 percent return may sound like a tall order in a world of near-zero-percent interest rates on savings accounts and Treasury notes. And if you rely on those antiquated instruments, you're right, 12 percent is not in your future.

But dividend stocks are another story.

In fact, I've compounded my own money 18 percent a year, meaning it doubles every four years.

As I've detailed many times, I didn't start out with a big nest egg or a huge inheritance — I just had a few thousand dollars in a 401(k) that I rolled into Altria, and kept aggressively adding to that position over the years, while adding other dividend payers to the mix along the way.

The point is, the math is compelling. And if more people stopped wasting precious cash on exorbitant items like $30,000-per-year preschools and instead bought carefully chosen dividend stocks, there would be plenty of truly wealthy people in this country.

How the Other Half Lives? Not Well

Unfortunately, statistics show that just isn't happening. Take this shocking fact: According to a recent study by economists at Harvard's Kennedy School of Government, it's estimated that 46.1 percent of all people in the United States die with less than $10,000 to their name.

"Many of these households also have no housing wealth and rely almost entirely on Social Security benefits for support," the study notes, as reported by *USA Today*.

If you know anything about basic economics, you know Social Security is certainly not a dependable, sustainable system.

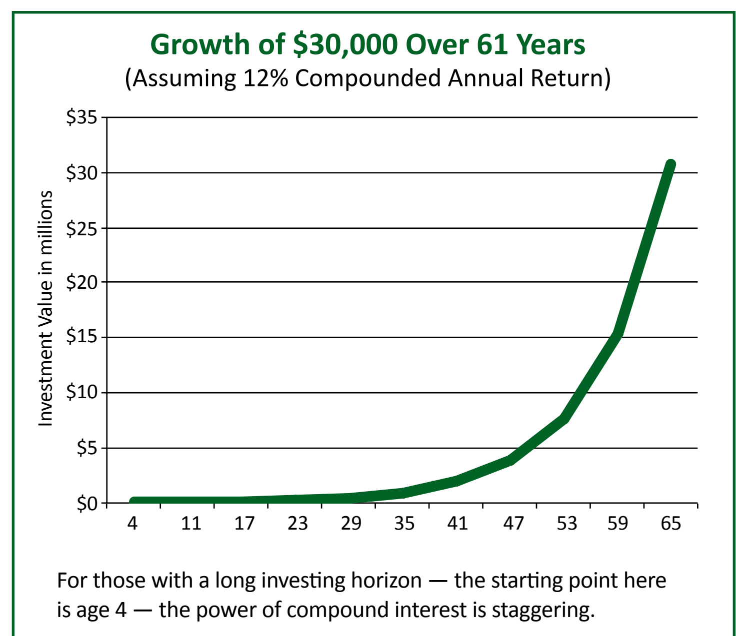
Baby boomers may be able to capture the last of the fizzling benefit pool, but those younger would be lucky to have any scraps left by the time retirement rolls around. (Based on current trends, Social Security will be insolvent by the year 2033, according to a 2012 report from the trustees of the program.)

What then for these non-savers and non-investors? And more importantly, are the meager payouts of Social Security any real way to survive and thrive?

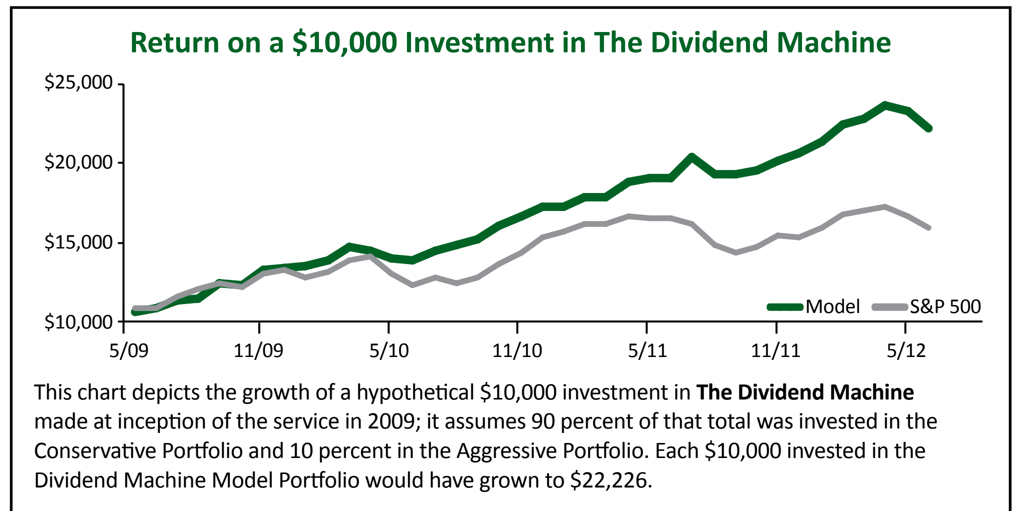
Not a chance — you'll definitely want more. At the very least you'll want enough so that you won't have to depend on Social Security for survival, in the event that the worst-case scenario does occur and it gets stripped to the bone and means-tested for new applicants.

All I can say is, breathe a sigh of relief if you're reading these words right now. As a subscriber to **The Dividend Machine**, you have a leg up on millions of others who are well on their way to joining that 46 percent. Even if you're currently starting from a small base of income and savings, you at least understand what you can do with that money to secure your future.

Dividend stocks, bought at the right entry



For those with a long investing horizon — the starting point here is age 4 — the power of compound interest is staggering.



This chart depicts the growth of a hypothetical $10,000 investment in **The Dividend Machine** made at inception of the service in 2009; it assumes 90 percent of that total was invested in the Conservative Portfolio and 10 percent in the Aggressive Portfolio. Each $10,000 invested in the Dividend Machine Model Portfolio would have grown to $22,226.

prices and held through years of dividend increases, can be your retirement salvation, just as they were for me and will prove to be for thousands of **Dividend Machine** readers.

Angling for that 12 percent return per year is key. Since inception in 2009, the **Dividend Machine** Portfolios — based on my recommendation of keeping 90 percent of your investing funds in the Conservative Portfolio and 10 percent in the Aggressive ledger — have returned 28.7 percent annually.

Someone who invested $10,000 in 2009 would have $22,226 now (see chart above).

To achieve that feat, we didn't need any esoteric or risky trading strategies. We didn't have to follow the path of hedge funds, or make short bets, or rocket in and out of positions with blinding speed. We just needed to follow one of the most boring, predictable strategies on Wall Street — buy low, and hold.

No tricks, that's it.

And to make it as easy as possible, every month in the **Dividend Machine** service, I provide the list of positions we hold, and a chart showing the recommended "buy-in" prices.

On top of that, every Tuesday, subscribers receive an email that lists the stocks currently at or near those levels, telling you exactly what you should be watching for and buying into to build up your own portfolio over time. It's really that simple.

Lessons Learned on the Cheap

I started off this newsletter talking about my daughter. Thankfully, the financial coaching I've been doing all these years has resonated.

When she was 9, she asked me, "Daddy, are we rich?"

I said, "Honey, we don't have a big house, and Daddy drives an old beat-up Jeep. How can we be rich?"

She looked at me and shook her head. "Dad, I'm not dumb. Everyone knows if you spend all of your money on your house and car, you won't have enough money to invest and become rich."

To think she's learned that valuable lesson, despite not having a fancy education from one of the finest preschools money can buy. Yep, I think she'll be just fine. ■

Bill Spetrino is a professional investor who has earned millions for himself and his investors solely through strategic investing. A trained accountant, he graduated from John Carroll University in Ohio and spent a decade teaching. A lifelong entrepreneur as well, Spetrino set out to understand and codify a simple dividend investing strategy for life, an idea that eventually led to the creation of **The Dividend Machine**. He wrote about it in his book, *Consume, Consume, and Consume More*, covering how to pick the kinds of dividend stocks Warren Buffett or the late Sir John Templeton would recommend, long-term cash generators with handsome appreciation as well. His dividend picks now generate all of his family's living expenses and more, and they keep on growing. He consults with a worldwide base of clients on investing and tax planning from his home in Ohio.

IMPORTANT

As a subscriber to **The Dividend Machine**, you may have opted to get this newsletter with our convenient Automatic Renewal program. If you decide not to cancel your subscription, your credit card will be billed each year; you'll see **NMX*Dividend Machine** on your credit card statement. Thank you.

Conservative Portfolio Trade Alert: Apple, Inc.

I didn't understand the allure of Apple (AAPL) until the day my daughter got her first iPod. The way she gushed about the product, telling me that Apple was the "greatest company in the world," demonstrated the type of customer any business desperately wants: an evangelist for the brand.

Of course, that wasn't yet enough for me. I added it to the list of stocks I follow, but continued to focus on our bread-and-butter dividend players like Altria and Philip Morris. After all, as great as Apple seemed on closer inspection of its fundamentals, it still lacked a key ingredient: a dividend.

Later, the iPad arrived. My wife got one, and my daughter quickly took it over. She showed me the apps and explained all the various ways it was a breakthrough device. She used it fervently, on a daily basis. Not too long after, when she started begging for an iPhone, it was clear — my daughter was addicted to Apple products.

But having listened to her reasoning, and seeing how and why she used Apple products, the light went off in my head, and I realized what David Einhorn and many other Apple stockholders already know: Apple isn't just a hardware company, it's also a software company. And not only that, its fanatical customer base is getting more and more hooked on the Apple ecosystem, fueling the company up for years of high-octane growth prospects.

Think of Apple's various sources of revenue: The operating system, iTunes, cloud computing and the app store are all basically software that is used on the (very profitable) hardware: the iPods, iPhones, iPads and Macs.

Apple has sold over 344 million iPods and 218 million iPhones. That's a customer base that keeps growing, in the U.S. and worldwide. If you doubt their popularity, just ask your children and grandchildren about Apple. You'll get an earful.

From our point of view, however, it's not useful to simply get caught up in the Apple mania. It's our job to determine if this stock passes our tests of income, safety and growth potential. I'll break it down for you here.

Income: I didn't understand why a company like Apple wasn't paying a dividend. But in February the leadership finally relented to market demand, and announced a $10.60 per share annual dividend, starting in 2012. That represents a yield of slightly less than 2 percent at my recommended buy price.

Some may react by saying, "That's too low. I want better yield than that." But like hockey great Wayne Gretzky once said, "I skate to where the puck is going to be, not where it has been."

In 2011, Apple grew earnings per share by 78 percent, and by more than 73 percent in the past five years. Now, I don't expect that torrid pace to continue going forward. But I can see 18 percent annual EPS growth, which is amazing given the current size of the company.

My feeling is Apple will have no trouble increasing its dividend going forward by 20-plus percent annually; an almost 2 percent yield can turn into an almost 4 percent yield in three years.

Safety: Many people are worried about Apple's future, citing Nokia, Research in Motion and other tech companies which had a great product but have collapsed as others have caught up and surpassed them.

But RIMM's Blackberry or Motorola's RAZR are not in the same league as Apple. Such one-off products don't engender the same devotion as Apple. Those who buy iPhones and iPads are drawn in by the convenience, ease of use, and technical brilliance. They are built to be incredibly user-friendly, and they draw people into an interconnected ecosystem that not many want to quit. Most who buy one Apple product will purchase at least one more, and they'll continue to spend money on iTunes, apps and other products.

Apple is also adept at constantly improving features, prompting customers to upgrade every time a newer version is available. Unlike Microsoft or Oracle (who we still like very much

for other reasons), whose software can be pirated or copied for free, Apple's software is part and parcel of the hardware — it is all intertwined brilliantly. To quote the aforementioned Einhorn, "Rather than see Apple as a hardware company, see it as a software company that monetizes its value through the repeated sales of high margin hardware."

Because of that, there's safety built in. Another safe aspect is the fact Apple continues generating cash flow in an enormous, never-before-seen fashion. The company now has $110.2 billion in cash and investments sitting on its books.

It has about $28 billion in cash, with the rest in a blend of short- and long-term investments, all with zero long-term debt. No other company on earth is that "safe" from a cash standpoint.

For those who prefer global diversification for safety purposes, know that 64 percent of all of Apple's sales are international — this isn't just a U.S. success story.

Growth Potential: As I said earlier, Apple has grown its EPS 73 percent in the past 5 years annually. Now the company has authorized a stock buyback as well as the dividend, which starts in Q4 of 2012. In the past year, Apple has accumulated over $40 billion in free cash flow.

APPLE, INC.	
SYMBOL	AAPL
ANNUAL DIVIDEND	$10.60
DIVIDEND YIELD	1.8%
MARKET CAP	$536.20 BILLION
52-WEEK RANGE	$310.50-$644.00

Taking everything into consideration, it's nearly impossible to imagine a scenario where it will not continue to grow. The question is, will it be 15 percent, or 25 percent? Maybe 45 percent, 60 percent, or the 78 percent they earned in 2011? All are good for a long-term value investor.

With all that said, a key component (as always) is whether we're entering at a great price. Apple should earn about $47 per share in the fiscal year ending September 2012, and should earn about $53 in fiscal year 2013. That is less than 9.5 times forward earnings, which is great for a company that should grow at double that.

But the deal gets better. If you back out the almost $121 of net cash, the forward price-to-earnings ratio is 8.56.

So, in essence, we're getting a below market forward price earnings ratio for one of the best EPS growth companies in the world. Like fellow Conservative Portfolio holding Visa (V), which has paid us a smaller than desired dividend but has tremendous expansion and appreciation potential, Apple is a nice combination of safety, growth and income. **I RECOMMEND APPLE (AAPL) AT OR UNDER $575.00, REPRESENTING 4 PERCENT OF YOUR CONSERVATIVE PORTFOLIO HOLDINGS.** ■

Company in Focus: Teva Pharmaceuticals

Whenever one of our stock positions struggles over any length of time, the questions roll in as subscribers get nervous. "Bill, was your analysis wrong on this one? Should we sell?"

It's the consequence of being a long-term value investor in a world intensely focused on quick-hit capital gains. That focus is fueled by the cable financial news networks, whose shows cater to the day traders and who are in the business of inciting panic for ratings. No one wants to watch a snoozy segment about how great it is to hold Johnson & Johnson and Altria for years on end and watch dividends grow.

No, they want the gossip on management shake-ups or the dissection of last quarter's sales figures or the breathless anticipation of the next big IPO, all in 30-second sound bites.

So as an investing nation, our attention span has been warped. People end up buying on the upswings, selling on the downswings, and basically doing everything possible to damage their long-term prospects of making any appreciable money in the stock market.

Which brings me to the topic at hand: Teva

Pharmaceutical Industries (TEVA), the world's largest maker of generic drugs.

We purchased Teva as the first pick in the International Portfolio on April 21, 2011, at a price of $45.01. Since then, it's been a roller-coaster ride. From that date, it touched $51 at the end of May, fell as low as $35.50 in September, rebounded into the low $40s in November, crossed $46 per share in January of this year, and dropped below $40 again in late May after the announcement of first quarter 2012 results.

All in all, it has struggled to pop above our buy-in price and stay there. So the question is, should we be worried?

My first answer is simple: No, because we are in this investment for the long term, and over a period of two to five years, I believe this stock will bounce to the value it deserves based on its fundamentals and future outlook. Generic drugs are an increasingly competitive business, but Teva is well positioned to continue its leadership role in this growing category.

But, that said, it's a fair request to analyze the short-term as well, and that brings us to the first-quarter numbers. Analysts reacted negatively, citing weakness in European sales and Copaxone sales deemed less than satisfactory. (Copaxone is a multiple sclerosis drug; Teva is battling with Mylan for exclusivity through the year 2015).

New CEO Jeremy Levin, who came from Bristol-Myers to replace Shlomo Yanai in May, also gave analysts the jitters. Levin would not confirm the company's prior guidance for fiscal year 2012, which is fair considering he just arrived on the scene, but was taken as reason for concern by some on Wall Street.

Despite all that, the underlying numbers were solid. Net revenue was $5.1 billion, up 25 percent from $4.1 billion in the same quarter of 2011. If Teva loses exclusivity on Copaxone, it'll hurt, but it won't be devastating. After all, this is a company that boasts a generic product line 1,300 strong, with up to 70 new drugs in development. It's diversified and — something we love in **Dividend Machine** — its positioning in a market with high barriers to entry makes it difficult for competitors to gain traction.

All told, the company itself has performed well since we purchased our shares, hitting or exceeding estimates the past four quarters. Teva is expected to earn $5.84 per share going forward; with a simple multiple of 9 times earnings, it should sell for $52.56 per share, and not the high $30s its currently in.

One theory on the relative sluggishness in the stock may not be Teva itself, but the uncertainty facing the country in which it's located.

Indeed, there have been increased tensions between Israel and Iran. I can't say that's not a worry, but in Teva's favor is the fact its operations are not wholly centralized within Israel's borders but are spread out over 60 countries worldwide.

Are investors scared because of those tensions? I don't know. What I do know, besides the fundamental factors I've already outlined, is someone else thinks Teva is priced well too, and his vote of confidence carries weight: the chairman of Teva Pharmaceutical. Phillip Frost purchased one million U.S.-listed shares on May 30, the first day of trading for the stock on the New York Stock Exchange. Previously, the U.S.-listed shares of the Israeli company traded on Nasdaq.

Frost bought shares at prices ranging from $37.82 to $39.57, according to the company. "This investment is simply a reflection of the strength of my conviction regarding Teva's bright future," Frost said in a company-released statement.

What should our plan be with Teva going forward? It's easy. Hold on, collect the dividend (currently over 2 percent), and wait for capital appreciation to take hold. Let the day traders sweat every earnings report — Teva is a company built for profitability and continued success.

Teva is the largest producer of generic drugs, who has increased their EPS over 20 percent compounded over the past five years. As a generation of people gets older and requires cheaper non-brand-name drugs to meet their healthcare needs, Teva should be able to grow EPS by 8 percent to 11 percent annually. At these levels, we could easily to see a move to $55 to $65 per share in the next 12 to 24 months. ■

July 2012 Dividend Machine Portfolios

CONSERVATIVE PORTFOLIO

Recommendation	Ticker	Portfolio Weighting	Entry Date	Entry Price	Recent Price	Dividend Yield	Dividend Paid Since Entry	Total Return	Buy at or Under	Exit Date	Sell Price
[illegible]	[illegible]	8%	28-Apr-09	$50.65	$62.12	3.87%	$7.01	39.19%	$68.00		
[illegible]	[illegible]	20%	1-May-09	$16.37	$32.96	4.98%	$4.45	215.67%	$27.75		
[illegible]	[illegible]	4%	7-May-09	$42.80	$74.66	2.71%	$5.38	83.11%	$48.50		
[illegible]	[illegible]	4%	19-May-09	$42.88	$61.51	3.30%	$5.39	56.14%	$58.00		
[illegible]	[illegible]	12%	27-May-09	$41.65	$84.38	3.67%	$7.73	153.03%	$72.00		
[illegible]	[illegible]	4%	18-Aug-09	$55.26	$86.59	3.19%	$7.24	66.70%	$85.00		
[illegible]	[illegible]	6%	4-Sep-09	$75.28	$82.46	4.80%	$8.52	21.75%	$82.00		
[illegible]	[illegible]	3%	26-Oct-09	$65.86	$80.28	N/A	$0.00	21.89%	$85.00		
[illegible]	[illegible]	4%	27-Jul-10	$26.06	$28.90	2.70%	$1.21	15.66%	$28.00		
[illegible]	[illegible]	4%	22-Sep-10	$19.04	$25.99	3.18%	$1.52	46.44%	$21.00		
[illegible]	[illegible]	4%	23-Feb-11	$73.50	$116.35	0.75%	$0.74	59.31%	$79.00		
[illegible]	[illegible]	4%	22-Jul-11	$42.07	$32.82	3.56%	$0.80	-20.99%	$43.00		
[illegible]	[illegible]	4%	26-Sep-11	$23.96	$30.99	2.80%	$0.46	31.37%	$26.50		
[illegible]	[illegible]	4%	27-Feb-12	$28.86	$26.81	0.88%	$0.06	-7.10%	$29.50		
[illegible]	[illegible]	4%	24-Apr-12	$33.03	$27.50	1.29%	$0.09	-16.47%	$35.50		

AGGRESSIVE PORTFOLIO

Recommendation	Ticker	Portfolio Weighting	Entry Date	Entry Price	Recent Price	Dividend Yield	Dividend Paid Since Entry	Total Return	Buy at or Under	Exit Date	Sell Price
[illegible]	[illegible]	8%	various	$9.75	$4.06	8.14%	$0.89	-54.83%	$12.50		
[illegible]	[illegible]	6%	2-Oct-09	$33.15	$63.45	1.76%	$2.68	100.44%	$41.00		
[illegible]	[illegible]	6%	15-Jan-10	$34.20	$26.48	0.14%	$0.04	-22.54%	$37.50		
[illegible]	[illegible]	12%	various	$11.66	$7.28	0.53%	$0.10	-35.49%	$14.00		
[illegible]	[illegible]	6%	26-Feb-10	$25.37	$24.78	1.72%	$0.74	-0.45%	$28.00		
[illegible]	[illegible]	4%	6-May-10	$25.63	$34.43	N/A	$0.00	34.33%	$29.00		
[illegible]	[illegible]	4%	20-May-10	$14.50	$11.68	2.94%	$0.87	-12.47%	$14.00		
[illegible]	[illegible]	5%	25-Jun-10	$135.97	$92.80	1.95%	$3.26	-30.43%	$144.00		
[illegible]	[illegible]	5%	16-Aug-10	$33.78	$49.54	N/A	$0.00	46.65%	$36.00		
[illegible]	[illegible]	8%	21-Dec-10	$19.56	$16.48	1.91%	$0.32	-14.76%	$18.00		
[illegible]	[illegible]	8%	various	$9.57	$4.19	11.52%	$0.75	-54.69%	$15.80		
[illegible]	[illegible]	6%	9-Aug-11	$24.00	$36.19	4.39%	$0.80	50.79%	$24.00		
[illegible]	[illegible]	6%	—	—	$51.41	—	—	—	$42.00		

INTERNATIONAL PORTFOLIO

Recommendation	Ticker	Portfolio Weighting	Entry Date	Entry Price	Recent Price	Dividend Yield	Dividend Paid Since Entry	Total Return	Buy at or Under	Exit Date	Sell Price
[illegible]	[illegible]	6%	21-Apr-11	$45.01	$38.94	2.52%	$1.21	-11.36%	$52.00		
[illegible]	[illegible]	4%	24-Aug-11	$12.92	$11.90	N/A	$0.00	-7.89%	$13.00		
[illegible]	[illegible]	4%	15-May-12	$44.00	$41.52	N/A	$0.00	-5.64%	$44.00		

SOLD POSITIONS

Recommendation	Ticker	Portfolio	Entry Date	Entry Price	Dividend Paid Since Entry	Total Return	Exit Date	Sell Price
[illegible]	[illegible]	Conservative	6-May-10	$27.25	$1.45	79.88%	27-Jan-11	$36.50
[illegible]	[illegible]	Conservative	16-Jun-09	$48.25	$2.00	23.48%	22-Oct-11	$56.74
[illegible]	[illegible]	Conservative	6-Jul-09	$34.27	$3.53	67.55%	27-Feb-12	$53.48
[illegible]	[illegible]	Conservative	31-Dec-09	$27.18	$2.61	58.36%	27-Feb-12	$37.53
[illegible]	[illegible]	Aggressive	4-Sep-09	$19.54	$1.07	6.55%	27-Oct-11	$19.75
[illegible]	[illegible]	Aggressive	4-Nov-10	$8.74	—	8.70%	24-Apr-12	$9.50

*As of close June 11. *Denotes recommendation not yet purchased. Returns include all reinvested dividends at concurrent recommended buy prices.*

The Dividend Machine

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Closing Thoughts

The thought of retirement from the 9-to-5 working world — once touted as a time of exciting possibilities, with the freedom to play, travel and toss the alarm clock in the trash — is now nothing more than an unattainable fantasy for many Americans.

Studies show that, as medical science helps us live longer, the pressures of not having enough money to retire on weigh on the minds of millions.

Indeed, the reality for many folks is that they couldn't retire at 65 or 70 years old even if they wanted to. The gap between their income and their liabilities is just too great. (A study in 2011 by Wells Fargo found that 25 percent of respondents figured they'd need to work until at least age 80.)

Obviously, economic conditions play a role. But the truth is, much of this growing crisis could be fixed if people did one thing: take control of their own retirement destiny.

In this month's issue, I touch on the ridiculous things some will spend money on (like a $30,000 preschool education), while a significant portion of the population — rich and poor alike — continue ignoring their retirement preparation.

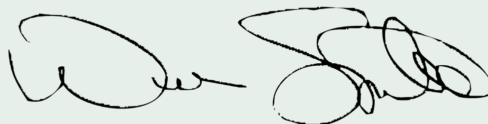
As a subscriber to **The Dividend Machine**, however, I'm confident you won't end up in the frightening circumstances of not being able to survive and thrive in your golden years. Why? Because you know the incredible power of saving and dividend investing.

Actions to Take Now:

Action No. 1: Buy Apple (AAPL) at or under $575.00, representing 4 percent of your Conservative Portfolio holdings.

Action No. 2: I'm officially dropping Honeywell (HON) from our Conservative Portfolio watch list. Unfortunately, the share price ran out of range before the newsletter could make it into the hands of readers, and shows no signs of coming back soon. It's a great company, however, so I may one day add it again if it returns to value levels.

Sincerely,



Bill Spetrino

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