

The Dividends From Far, Far Away

U.S. Investors Seeking Income Find Payouts Overseas Can Pump Up Returns

By SHEFALI ANAND

Dividend-seeking investors should cast their gaze abroad.

Foreign stocks have much more attractive yields these days. A leading index of big-cap stocks in developed overseas markets yielded a 3.7% payout as of July 31, compared with a 2.4% rate for similar U.S. stocks.

As aging baby-boomers in the U.S. look for ways to get income, a number of mutual funds and exchange-traded funds have been launched with a focus on dividend-paying foreign stocks. Most recently, fund giant American Funds, which rarely trots out new funds, filed for an income-oriented foreign-stock fund to be introduced this fall.

Dividend-paying funds and stocks are traditionally safer bets in difficult markets such as the current one. But many of the highest yielding stocks in the U.S. are financials, which have been hurt by the turmoil in the mortgage market.

No one knows when companies such as [Citigroup Inc.](#) and [Merrill Lynch & Co.](#) will dig their way out of the current mess, so buying their shares is hardly a conservative bet right now. A number of banks including Citigroup, Wachovia Corp. and National City Corp. have chopped their dividends to conserve capital.

Overseas too, a lot of the high-yielding stocks are financials. Some, such as [UBS AG](#) are embroiled in the U.S. mortgage-market rout. But others stocks, such as [HSBC Holdings PLC](#), which yields 5.4%, [Lloyds TSB Group PLC](#), with a 12% yield, and [Barclays PLC](#), with a 9.8% yield, have been hurt less by the U.S. mortgage market.

Glenn Zannotti, a 45-year-old account manager for a nonprofit in Tulsa, Okla., holds a portfolio of U.S.-traded shares of 10 foreign companies, all of which yield more than 4%. Recently, he has been buying financial stocks, such as [Barclays](#), [Deutsche Bank AG](#) and [Royal Bank of Scotland Group PLC](#), which he considers "good long-term value" and a complement to his U.S.-stock holdings.

Of course, high-yielding foreign stocks bring their own risks. Foreign banks will be hit hard if the global slowdown intensifies. These firms could get swept up if housing prices get worse in their home markets.

What's more, any U.S. investor owning a foreign stock faces currency risks. In the past few years, foreign currencies have been rising against the dollar, pushing up the value of foreign shares held by U.S. investors. But the dollar has made a comeback in recent weeks, and if this continues, foreign shares could hurt returns for Americans.

Why do foreign companies pay higher dividends? There was a time when U.S. companies had much higher payouts. But over recent decades, U.S. companies have retained more earnings to plow them back into the business. They also have done a lot of share buybacks in recent years.

Meanwhile, many foreign companies take more a traditional approach to dividends: the money they earn belongs to their shareholders, and they return it to investors in the form of rising dividends. Also, earnings growth in some Asian countries such as Taiwan is spurring their companies to start paying dividends or increase the dividends they already pay.

According to calculations by Jesper Madsen, manager of Matthews Asia Pacific Equity Income Fund, dividends from companies included in the MSCI AC Asia Pacific Index have grown at an average of 18% annually between 2003 and 2007, as compared with 6% for companies in the Standard & Poor's 500-stock index, on an equal-weighted basis.

Mr. Madsen notes that in some countries such as Taiwan, some of the highest-dividend-yielding companies are technology companies. That is quite different from the situation in the U.S. where many tech companies don't pay dividends at all.

Vincent McBride, manager of the recently launched Lord Abbett International Dividend Income Fund, says he has been finding gems in foreign companies that are subsidiaries of large multinationals. An example is Telefonica O2 Czech Republic, a unit of one of the world's leading phone companies, Telefónica SA. It yields about 9.8%.

The [Morningstar](#) Inc. data base has about two dozen foreign mutual funds that seek out dividend-paying stocks; a third of them are "global," meaning they can invest in the U.S. if the manager so wants. Pure foreign dividend funds go by "International Equity Dividend" or "Equity Income" in their titles, while funds that have income only as a secondary objective go by names like "Growth & Income."

The largest fund by assets is the T. Rowe Price International Growth and Income, at \$2.9 billion, and is also among the oldest with a 1998 inception. The fund is down 19% this year, thanks partly to its 24% stake in financials, but has a 14% annualized return over the past five years, according to Morningstar. Its 12-month yield is 2.26%.

In addition, there are 22 foreign dividend-oriented exchange-traded funds, mostly launched since 2006. Sixteen of these are from WisdomTree Investments Inc., a company which subscribes to the research of Jeremy Siegel, a professor at the University of Pennsylvania, who believes that dividends are the most objective way to value a company.

The ETFs go from broad ones, such as the PowerShares International Dividend Achievers Portfolio, launched in 2005 and yielding 4.1%, to specialized ones such as the WisdomTree International SmallCap Dividend, which currently yields 2.6%. These are two of the largest such ETFs, with slightly more than \$460 million in assets.

The foreign-focused fund with the highest yield currently is Henderson Global Equity Income, with a 12-month yield of 8.8%, followed by the iShares Dow Jones EPAC Select Dividend ETF with an 8.3% yield. The highest-yielding fund may not be suitable for all investors. For instance, the iShares DJ EPAC ETF has 50% of its assets in financials.

Most investors are advised to pick a broadly diversified fund, across countries and sectors. Steve Janachowski, a financial adviser in Tiburon, Calif., suggests looking at a "global" fund, such as the Tweedy, Browne Worldwide High Dividend Yield Value Fund, which was launched last year.

"I would use that as part of my overall foreign and global strategy," Mr. Janachowski says.

Write to Shefali Anand at shefali.anand@wsj.com