An Introduction to
Capturing Dividends

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A simple dividend capture strategy guide from Dividend.com

Dividends 101: The Purpose of Dividends and Risks of Trading Around Them

First, a Bit of History…
Traditionally, dividends were meant as a reward for long-term shareholders. You bought a stock, held onto it for a long time, and got paid to own it. The vast majority of all investment gains were derived from dividends, since stock prices simply didn’t move very much.

Companies in modern times still intend for dividends to serve that same purpose: rewarding investors who are in the stock for the long haul. A solid base of long-term shareholders is a very important asset for public companies to have, because it helps reduce share volatility. A solid history of steadily increasing dividends also speaks to a company’s financial well-being. From an investor standpoint, dividends are attractive because they can provide compounding returns when re-invested, or a steady stream of income when the dividends are cashed.

Increasing numbers of modern investors look at dividends quite differently, however. Many people now see dividend payouts as trading opportunities. With diligent research, the right market conditions, and a full understanding of how the dividend system works, traders have developed methods to collect dividends without holding stocks for very long at all – sometimes for less than twenty-four hours. This practice of trading around dividend dates is called dividend capture.
Warning: Dividend Capture is NOT for Everyone
To be clear, capturing dividends is a type of trading. Executing a successful dividend capture strategy requires much more dedication, research, planning, and timing than traditional dividend investing.

Thus, dividend capture is significantly riskier than a conservative long-term “buy and hold” strategy.

If you’re not completely confident in your ability to get in and out of stocks relatively quickly, then dividend capture probably isn’t for you. If you’re risk-averse and can’t afford to make losing trades, then dividend capture probably isn’t for you. And if you’re brand new to investing in the stock market, then dividend capture definitely isn’t for you.

Now that you understand the history and intended purpose of dividends, as well as the inherent risk in trying to trade around them, let’s get into the fundamentals of dividend capture.

Dividend Capture Basics

Why Would Someone Want to “Capture” a Dividend?
The general idea behind capturing dividends is to own a stock for a short amount of time and still collect a dividend. As we learned earlier, this practice violates the very reason why companies pay dividends in the first place – to build, maintain, and reward long-term shareholders.

So, why do people capture dividends? Probably because the lure of so-called “easy money” is too strong for people to resist. That’s not to say capturing dividends isn’t a legitimate trading strategy – you just need to be aware of all the factors affecting the capture process.

It sounds so simple in concept: buy a stock right before it’s about to pay a dividend, collect the dividend, and then sell the stock. As you’ll soon learn, however, there’s a lot more to it than that.
The All-Important Ex-Dividend Date

If you’re going to capture dividends, you’ll need to first understand how dividend payouts work. Each time a company announces its next dividend, they normally include three key dates:

1. **Ex-Dividend Date** – You must own the stock *before* this date to collect the upcoming dividend.
2. **Record Date** – This falls two business days after the Ex-Dividend Date, and is the day on which a company physically looks at its records to see what shareholders are eligible for the upcoming dividend.
3. **Pay Date** – This is the date a company actually sends its dividend payouts to eligible shareholders.

As you’ll notice above, **you must own a stock before its Ex-Dividend Date** in order to receive the next dividend. **You can then sell the stock on its Ex-Dividend Date** and still receive the dividend. Most brokers adhere to this rule, but yours may differ, so we always advise checking with your broker first to ensure this general practice holds true for you.

The purpose of the ex-dividend date relates to brokers’ three-day clearing period. It normally takes three business days for any stock transaction to “clear,” meaning the transaction is finalized and you’re actually on the company’s books as a current shareholder. Since a company looks at its books on the Record Date to determine shareholder eligibility, you’ll need to buy a stock three business prior to the Record Date – which is the day before the Ex-Dividend Date.

**Note: Holidays Can Affect Ex-Dividend Dates**

Please note that federal holidays (when the markets/banks are closed) can affect Ex-Dividend Dates. Sometimes, these dates will be adjusted at the last minute to accommodate the schedules of banks. Always double check your dates before purchasing any security!

Companies set these dividend dates to make it easy for them to determine what shareholders to pay dividends to. In addition to the eligibility requirements, there is another huge factor regarding the Ex-Dividend Date you absolutely must recognize.
A Stock’s Share Price Will be Negatively Adjusted on the Ex-Dividend Date to Reflect the Upcoming Dividend Payout

People new to dividend capture often fail to realize that stock exchanges will negatively (and automatically) adjust a stock’s share price to reflect its upcoming dividend payout on its ex-dividend date. Why? To prevent people from “gaming” the dividend system.

As you’re now well-aware, companies pay dividends in order to build, maintain, and reward long-term shareholders. To prevent the hit-and-run effect of traders collecting dividends, stock exchange operators came up with a system to lower the stock’s price by an amount proportionate to its dividend payout.

Negative Price Adjustment on Ex-Dividend Date

Let’s say Stock XYZ currently trades at $30 per share on July 1st. XYZ is slated to pay a $1 dividend on August 1st, and its Ex-Dividend Date is July 2nd.

Theoretically, XYZ will open at $29 on July 2nd ($1 less than its previous closing price) to reflect the upcoming $1 dividend. We use the term “theoretically” here because other factors can affect a stock’s price (positively or negatively) during premarket trading. You’ll rarely see a stock open up for trading down by an amount exactly equal to the dividend payout, but it’s usually pretty close.

So, if you bought XYZ on July 1st for $30 and sold it on July 2nd for $29, you’d be looking at a $1 loss, which you’d make up for by collecting the $1 dividend on August 1st. However, when subtracting taxes and brokerage fees, you’d still be looking at a loss, or at best, you’d break even.

Clearly, there’s much more to the dividend capture strategy than initially meets the eye. To actually make money by capturing dividends, you’ll likely need to develop a strategy that involves more than simply buying the day before the ex-date and selling on the ex-date.

Tax Implications of Captured Dividends

Current tax laws (as of 2011) in the United States give investors a break when it comes to dividends – provided that you hold the stock at least 61 days. If you meet that holding window, your dividend payments will be taxed at a 15% capital gains tax rate. Otherwise, you’ll be taxed at your normal income tax rate, which varies depending on your current tax bracket.
Only **qualified dividends** are eligible for this tax break, however. By definition, qualified dividends are regular dividend payouts for which capital gains tax rates are applied. For a dividend to be qualified, it must meet certain criteria.

### Requirements for Qualified Dividends

1. The dividend must be paid by an American company or by a qualifying foreign company.

2. The dividend must not be listed with the IRS as a dividend that does not qualify. For example, special/one-time dividends are usually **not qualified**.

3. The minimum holding period of 61 days must be met.

You can find out whether an upcoming dividend payout is qualified or not by consulting our [Ex-Dividend Calendar](#):
You can also view whether a dividend is qualified or not on any stock’s profile page. Here’s an example of Microsoft Corp (MSFT):

![Recent/Upcoming Dividend Payouts for MSFT](image)

Of course, taxes aren’t your only concern when capturing dividends, but you want to ensure you’re maximizing your potential profits. In the next section, we’ll lay out a dividend capture strategy that will allow you to take advantage of tax breaks and help protect against the negative price adjustments on the ex-dividend date.

### A Simple Dividend Capture Strategy

#### Timing is Everything

We know that a dividend stock’s price is automatically negatively adjusted on its Ex-Dividend Date to reflect the upcoming payout. Did you also know that a stock’s price tends to rise in the days and weeks leading up to its Ex-Dividend Date? This phenomenon occurs because as a stock’s ex-dividend date approaches, the demand for the stock increases. The influx of investors looking to capture the upcoming dividend pushes the stock price up, and timing this run-up is a very important part of a successful capture strategy.

Of course, every stock reacts differently during the period in between its Ex-Dividend Dates. Some will recover quickly from their negative price adjustments, while others take weeks or even months. Plus, factors such as earnings reports, cyclical changes, and analyst upgrades and downgrades can all affect stock prices. You’ll need to do extensive research on each individual stock, pulling up long-term (at least one-year) charts and matching up price movements with Ex-Dividend Dates.

Generally, you’ll want to purchase stocks at least a couple of weeks prior to their Ex-Dividend Date to benefit from the normal price run-up. Getting in on stocks early will help offset the price drop you’ll be absorbing on the Ex-Dividend Date. If you wait too long to purchase the shares, you’ll be buying the stock at its short-
term “top” just before its ex-date. Check out the example chart below for more detail.

As you can see, the price of our example stock ran up significantly prior to its Ex-Dividend Date, was automatically negatively adjusted on the Ex-Date, and then a few days later, begins its run up once again.

If you time your purchase correctly, you’ll see significant price appreciation leading up to the Ex-Date and then be able to sell on the Ex-Date. But when should you sell the stock and move on to the next one?

Many investors will simply sell the stock on its Ex-Dividend Date, since it’s the earliest you can get out of the position and still collect the upcoming dividend. The practice also gives you ample time to allocate your funds toward shares of another dividend payer, which is an important part of our simple capture strategy.

Repeat the Process Six Times Per Year
Our simple dividend capture strategy will allow you to collect 50% more dividends per year than a more traditional buy-and-hold strategy and still take advantage of the dividend tax rate of 15%. Remember, you must hold a dividend stock for at least 61 days for the payout to qualify for the lower tax rate.

Six times sixty-one is 366 – roughly the same amount of days in a given year. Thus, we can repeat our capture process six times per year, allowing us to collect six dividend payouts instead of the usual four. That’s 50% more dividends!
Other Capture Strategies and Resources

This report is geared toward helping you understand the basics of capturing dividends. Our simple capture strategy is just one way to capture dividends, however.

Alternative Capture Methods
Over the years, more sophisticated traders have come up with dozens of methods to capture dividends and trade around dividend dates. Many of these methods involve much more complicated trading techniques using options, margin, and other methods that provide trading leverage and hedging. Because these strategies are much too involved for most investors, we won’t be covering them in this report.

More Dividend Resources
Your biggest ally in capturing dividends is our Ex-Dividend Calendar at Dividend.com. As of April 2011, we provide dividend payout and date information for nearly 4,600 stocks on U.S. exchanges, including common shares, preferred shares, ETFs, and more.

Visit our Ex-Dividend Calendar on Dividend.com

We hope you find this report interesting and useful, and we welcome all comments and feedback via e-mail to contact@dividend.com.