NEWS FOR INVESTORS

Dividend Growth Is A Differentiating Factor In Long-Term Stock Performance

(NAPSA)—Dividends have made a comeback from a period during the 1990s when investors prized capital growth more than dividends. Several factors will significantly affect dividend growth going forward, explained Judith Saryan, portfolio manager of Eaton Vance Utilities Fund.

"Over 70 percent of all investment assets will be in the hands of retirees or near-retirees by 2020," Saryan said. "Although many retirees look to bonds for income, this income source is unlikely to grow during a period of low interest rates and bond yields. By contrast, dividend-paying stocks offer the opportunity to collect dividend income, while also benefiting from the potential for growth of capital."

Recent laws are helping to propel dividend growth. One is the Sarbanes-Oxley Act, passed in the wake of corporate accounting scandals. The Act ensures better overall corporate governance and more transparent financial reporting. The top tax rate on qualifying dividend income was also reduced to 15 percent from 38.6 percent in 2003. This makes dividends more attractive to investors and thus companies were motivated to raise their dividend—the only item on the financial statement that cannot be restated.

Another important factor is the dividend payout ratio (the amount that a corporation pays out in dividends relative to its earnings), which is currently at a historic low of 32 percent. Historically, the average payout ratio is over 50 percent. Yet, since the changes in tax law, many corporations have been raising their dividends.

"While we expect earnings growth to moderate as the economy slows, we anticipate dividend growth will continue at record levels," said Saryan. "With record amounts of cash on balance sheets—the so-called 'fat wallet' phenomenon—and rising interest from private equity firms, we expect corporations will feel greater pressure to prioritize the use of cash to pay dividends to their shareholders."

The significant impact of dividends on the total return of stocks over time is another factor. From 1926 to 2005, over 40 percent of the total return of stocks came from dividends, according to Ibbotson Associates and Standard & Poor's® index service 2005.

"Hypothetically, if an investor were to have reinvested those dividends, the total return coming from reinvested dividends would have potentially been even higher," said Judy Saryan. "Depending on the length of time an investor held the stock, dividends could have contributed between 70 and 80 percent of the total return of a stock."

But, perhaps the most important positive attribute of dividend-paying stocks is their historic outperformance as compared to stocks that don't pay dividends. Dividend-paying stocks outperform non-dividend payers by 300 basis points (3 percent) a year, according to Ned Davis Research (based on historical returns of Standard & Poor's 500 component stocks between 1972 and 2005). History also shows that stocks that initiate and grow their dividends tend to outperform others by 600 basis points (6 percent) per year (Ned Davis Research). Of course, past performance is no guarantee of future results.

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Eaton Vance Distributors, Inc., The Eaton Vance Building, 255 State Street, Boston, MA 02109