Tech dividends: What fund investors should know

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(AP) -- Investing is about give and take. Consider growth-oriented companies, which are focused on building business and expanding market share. When the economy improves, their stocks are likely to rise more sharply than those of well-established companies, such as General Electric and Johnson & Johnson. In exchange, growth stock investors pass up the potential for regular dividend income.

Most technology companies fall into this category. They spend heavily on new products and research to stay competitive. But many have built up so much cash that they're rewarding investors by starting to pay dividends, or by increasing them. It's an emerging trend that's giving tech investors solid dividend yields, along with strong potential returns from stock price appreciation.

Look no further than the biggest tech name, Apple. Its shares are up more than 50 percent this year, and its cash stockpile grew so large that it recently announced plans to begin paying a dividend. Starting this summer, Apple investors will get $10 billion in annual payments.

That move has made tech the second most-generous industry group in the Standard & Poor's 500 index. Other big tech companies such as Cisco Systems and Oracle have initiated dividends in recent years, and longtime dividend-payers such as Intel, IBM and Microsoft have increased their payouts.

It's drawing the attention of mutual fund managers who see growing

opportunities for investment income from a market segment that's historically been stingy. These managers don't think the payouts will hamper the ability of tech companies to grow, or slow stock price appreciation.

Tech is one of the key areas that will drive the dividend market for the next five years, says Laton Spahr, co-manager of the Columbia Dividend Opportunity fund (INUTX), which counts dividend-payers Microsoft, Intel and Microchip Technology among its recent top 20 holdings.

That's quite a change from the late 1990s, when Spahr was a financial analyst covering the semiconductor industry.

"Back then, none of my companies would entertain the idea of paying a dividend," he says. "There was a perception that once you started paying dividends, the market would penalize you because you were admitting that you no longer had growth in front of you."

There are plenty of reasons to believe that tech companies can distribute sizable dividends without cutting into earnings and stock price growth. But it's not a simple equation. Here are 6 things that mutual fund investors should know about tech stocks and dividends:

1. DON'T EXPECT REGULAR INCOME FROM TECH MUTUAL FUNDS:

It would seem logical for an investor seeking regular income from tech stocks to consider a fund specializing in tech stocks. But among 52 tech sector funds, just a handful make regular dividend distributions. Instead, managers reinvest the dividends their stocks generate. Rather than tech-specialty funds, consider those that primarily invest in dividend stocks, commonly labeled "equity income" funds. Many, like Spahr's fund, invest in plenty of dividend-paying tech names, and make quarterly

distributions.

2. TECH DIVIDEND BOOM IN EARLY STAGES:

Tech companies are increasing or initiating dividends faster than other segments of the market. But it's important to remember that most tech companies still don't pay dividends. Among large-cap companies - those generally valued at more than $2 billion - fewer than one-third of tech stocks pay dividends. Notable non-payers include data storage company EMC Corp. and computer maker Dell Inc. Google on Thursday announced plans to distribute a stock dividend to existing shareholders as part of a 2-for-1 split of its shares, but it hasn't joined the ranks of tech companies making regular cash payouts.

3. TECH ISN'T A BIG SOURCE OF DIVIDEND INCOME:

The average dividend yield of tech stocks tends to be below that of other industries. A stock's dividend yield is the amount of the annual dividend, divided by the share price. Among 10 sectors in the S&P 500, dividend-paying tech companies have the lowest average yield, 1.83 percent, even after Apple's dividend is factored in. Tech trails only consumer staples in terms of the dollar amount of dividends paid. But tech yields are lower because many top tech stocks have high share prices relative to their dividend payouts. For example, Apple shares are trading at about $622 apiece, so its $10.60 annual dividend will yield just 1.7 percent.

4. DON'T GET TOO ENAMORED WITH TECH:

Be careful not to load too much of your portfolio with tech stocks. The sector makes up 21 percent of the value of the S&P 500. If you invest in a fund that tracks that index, you already own roughly that same tech weighting in that fund. And many investors' tech exposure has grown because Apple's stock has surged, making it the world's most valuable

stock, and the most commonly owned in fund portfolios.

5. MINIMIZE EXPOSURE IF YOU'RE WORRIED ABOUT VOLATILITY:

Tech stocks are more volatile than the broader market, so expect choppy returns. For example, tech funds were among the worst-performing stock fund categories last year, losing an average 8 percent. This year, they're the top performers, averaging returns of 17 percent. Credit a strengthening economy, and Europe's recent progress in controlling its debt crisis. Europe is a huge market for U.S. tech companies, so its economy is a big factor in the recently improved tech outlook. "Last year, there was a crisis of confidence," says Matt Sabel, manager of the MFS Technology Fund (MTCAX). "But this year, it became clear that the world wasn't entering a double-dip recession." However, expect tech to get hit hard again if the economic outlook deteriorates.

6. DIVIDENDS CAN INSTILL FINANCIAL DISCIPLINE:

Dividends force corporate managers to be cautious spenders. Sabel reasons that dividend-paying tech companies are less likely to dip into their cash stockpiles to make a risky acquisition, or launch an ill-conceived research project. Relative to non-dividend-paying tech stocks, dividend-payers are likely to deliver steadier returns.

"When that dividend check has to be cut every quarter," Sabel says, "it does focus management on cash flow, and sometimes that's a good thing."

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