Red Alert: The Dangers of Dividend-Trap Stocks

Our regular readers know that most dividend stocks are bad investments. They are not the safe-havens that investors think. We recently hosted live training sessions on two dangerous types of dividend stocks:

- Fake Dividend Stocks
- False Dividend Stocks.

Last week, we published "Red Alert: Beware False Dividend Stocks" to keep clients away from stocks where dividend cuts could ruin their income portfolio.

In this report, we're here to warn about a third, less obvious yet dangerous dividend stock:

Dividend-Trap Stocks

Dividend-trap Stocks look good on the outside. They pay a dividend, and the underlying business is solid enough to afford the dividend. The problem is not the cash flows. It's the nosebleed valuation of the stocks.

No matter how healthy the dividend is, if the stock is priced to perfection, it's likely to go down and wipe out any gains you hope to get from the dividend payout. Dividend-trap stocks do not offer very high dividend yields (close to the 5-year zero coupon bond) because the stock price is so rich. So, the upside potential from the dividend payout is small compared to the downside risk from the overvalued stock.

In other words, Dividend-trap Stocks are good companies, but bad stocks, and they don't pay a yield large enough to make them worth the risk.

You don't want your "income stock" to crater due to a bad earnings report because the stock is priced for perfection, when you could collect the same yield in a far less risky security.

The only way to avoid Dividend-trap Stocks is to do proper due diligence to accurately assess companies' cash flows and stocks' valuations. As we've proven many times, investors must do their homework to get the truth about any business.

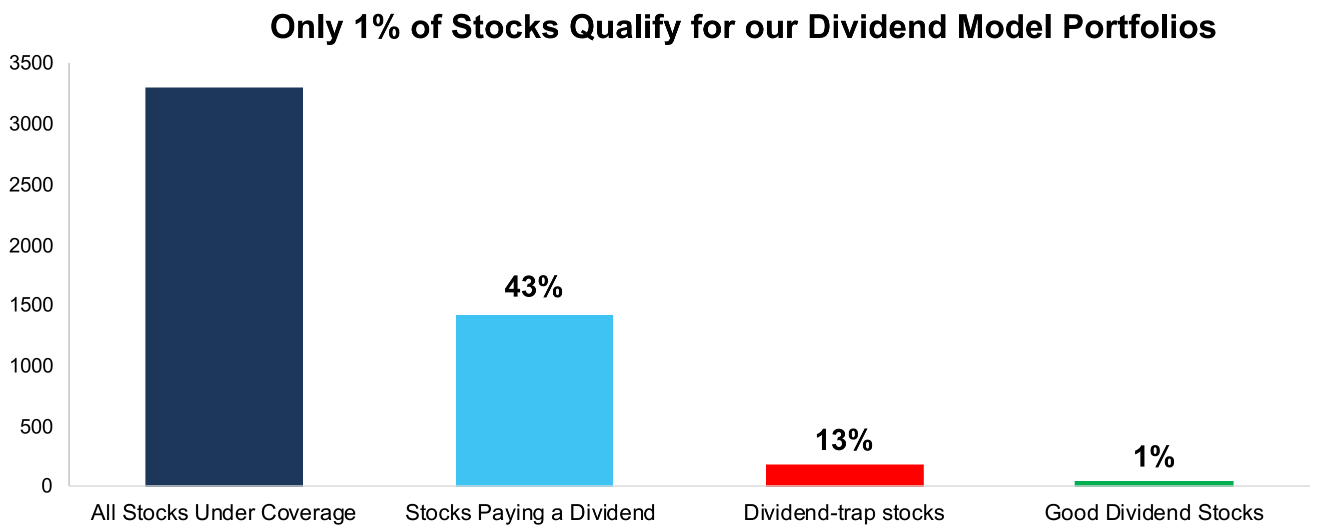
Below, we break down just how prevalent Dividend-trap Stocks are in the current market.

Pinpointing the Dividend-Trap Risk

To find Dividend-trap Stocks, we first screen our entire coverage universe for stocks that pay a dividend.

Of the ~3,300 stocks under coverage, 1,416 stocks, or 43%, pay a dividend. Only 44 stocks, or 1% of the universe qualify as Good Dividend Stocks and earn a spot in one of our dividend model portfolios: Safest Dividend Yield Stocks and Dividend Growth Stocks.

Figure 1: Dividend Paying Stocks in Coverage Universe – As of June 10, 2025



Sources: New Constructs, LLC and company filings

After we've identified the dividend stock paying universe, we then parse out the Dividend-trap stocks. Specifically, Dividend-trap Stocks have:

- A Neutral stock rating,
- An Unattractive or Very Unattractive rating for market-implied growth appreciation period(GAP), which indicates all good news is priced into stock, and
- A dividend yield equal to or below 4.0% (current risk-free-rate).

Per Figure 2, there are 181 Dividend-trap Stocks as of June 10, 2025.

Figure 2: Dividend Stocks with Low Yields – As of June 10, 2025

Dividend-trap Stocks	Avg Dividend Yield	Avg Market Cap ($mm)
181	1.5%	$18,731

Sources: New Constructs, LLC and company filings

The Dividend-Trap Stocks

Below, we reveal three of the 181 Dividend-trap Stocks. These stocks earn a Neutral rating and are so expensive that we see far more downside risk than upside potential. From an income perspective, the yield is very low, below the risk-free rate. From the capital appreciation perspective, downside risk dwarfs upside potential.

Figure 3: Three Dividend-Trap Stocks: As of June 10, 2025

Company	Ticker	Dividend Yield
WD-40 Company	WDFC	1.5%
Automatic Data Processing	ADP	2.0%
SBA Communications	SBAC	2.0%

Sources: New Constructs, LLC and company filings

WD-40 Company (WDFC: $244/share): 1.5% Dividend Yield

WD-40 earns its spot on the Dividend-trap Stocks list due to its strong earnings but overvalued stock.

In the trailing twelve months (TTM), WD-40 generated $82 million in net operating profit after-tax (NOPAT) and earns a top-quintile return on invested capital (ROIC) of 21%. Economic earnings, which account for changes to the balance sheet and represent the true profits of the business, are $55 million over the TTM. Additionally, the company generated $60 million in free cash flow (FCF) over the TTM. By all measures, WD-40 meets the criteria of a "good business."

However, it also meets the criteria of "bad stock". At its current price of $244/share a WDFC's price-to-economic book value (PEBV) ratio is 3.1. This ratio implies the company will grow profits over 3 times TTM levels. Furthermore, in the default scenario of our reverse discounted cash flow (DCF) model, WDFC has a market-implied Growth Appreciation Period (GAP) of greater than 100 years.

The company's current economic book value, or no growth value, is just $80/share, a 67% downside to the current price. In other words, $244/share embeds a rather large amount of future growth in profits. The 1.5% dividend yield does not compensate for the risk of the stock trading sideways or even falling closer to its economic book value. As a result, WDFC finds itself on the Dividend-traps Stocks list.

See Figure 4 for our detailed Stock Rating on WDFC.

Figure 4: WD-40's Stock Rating Details: Good Company, Bad Stock

Risk/Reward Rating	Quality of Earnings		Valuation		
	Economic vs Reported EPS	ROIC	2 yr Avg FCF (excl cash) Yield	Price to EBV	Market-Implied GAP
Very Unattractive	Misleading Trend	Bottom Quintile	< -5%	> 3.5 or -1 < 0	> 50
Unattractive	False Positive	4th Quintile	-5% < -1%	2.4 < 3.5 or < -1	20 < 50
Neutral	Neutral EE	3rd Quintile	-1% < 3%	1.6 < 2.4	10 < 20
Attractive	Positive EE	2nd Quintile	3% < 10%	1.1 < 1.6	3 < 10
Very Attractive	Rising EE	Top Quintile	> 10%	0 < 1.1	0 < 3
Actual Values					
WDFC	$4.06 vs. $6.27	21%	3%	3.1	> 100 yrs

Sources: New Constructs, LLC and company filings

Automatic Data Processing (ADP: $312/share): 2.0% Dividend Yield

Automatic Data Processing is also a Dividend-trap Stock due to its positive economic earnings and strong ROIC, but overvalued stock price.

In the TTM, Automatic Data Processing generated $4.1 billion in NOPAT and earns a top-quintile ROIC of 41%. Economic earnings are $3.3 billion over the TTM, and the company generated $1.8 billion in FCF over the same time. Automatic Data Processing certainly looks like a "good company" by all fundamental metrics.

The reason for its landing a spot on the Dividend-trap Stocks list is the high future cash flow expectations baked into its stock price. At its current price of $312/share ADP's PEBV ratio is 2.5. This ratio implies the company will more than double its profits from TTM levels. In the default scenario of our reverse DCF model, ADP has a market-implied GAP of greater than 100 years. In other words, Automatic Data Processing, must achieve the default revenue growth and margins in our DCF for >100 years to justify its current price.

The company's current economic book value is just $127/share, a 59% downside to the current price. As with WDFC, the expectations for future profit growth in ADP at $312/share are so high that we think all the good news and then some is baked into the current stock price. Downside risk in this stock dwarfs upside potential.

See Figure 5 for our detailed Stock Rating on ADP.

Figure 5: Automatic Data Processing's Stock Rating Details: Good Company, Bad Stock

Risk/Reward Rating	Quality of Earnings: Economic vs Reported EPS	Quality of Earnings: ROIC	Valuation: 2 yr Avg FCF (excl cash) Yield	Valuation: Price to EBV	Valuation: Market-Implied GAP
Very Unattractive	Misleading Trend	Bottom Quintile	< -5%	> 3.5 or -1 < 0	> 50
Unattractive	False Positive	4th Quintile	-5% < -1%	2.4 < 3.5 or < -1	20 < 50
Neutral	Neutral EE	3rd Quintile	-1% < 3%	1.6 < 2.4	10 < 20
Attractive	Positive EE	2nd Quintile	3% < 10%	1.1 < 1.6	3 < 10
Very Attractive	Rising EE	Top Quintile	> 10%	0 < 1.1	0 < 3
Actual Values					
ADP	$8.13 vs. $9.77	41%	2%	2.5	> 100 yrs

Sources: New Constructs, LLC and company filings

SBA Communications Corporation (SBAC: $225/share): 2.0% Dividend Yield

The third stock for today's report, SBA Communications Corporation, is like the prior two.

In the TTM period, SBA Communications Corporation generated $1.5 billion in NOPAT and earns a second-quintile ROIC of 12%. Economic earnings are $669 million over the TTM, and the company generated $1.3 billion in FCF over the same time. SBA Communications Corporation, just as with WDFC and ADP, could certainly be called a "good company."

Its valuation is not nearly as "good" though. At its current price of $225/share SBAC's PEBV ratio is 3.1. This ratio implies the company will more than triple its profits from TTM levels. In the default scenario of our reverse DCF model, SBAC also has a market-implied GAP of greater than 100 years.

The company's current economic book value is just $73/share, a 68% downside to the current price. The expectations for future profit growth baked into SBAC at $225/share leave no room for cash flow expectations to improve from current levels. As a result, there is little to no upside in the stock, and the 2.0% dividend yield is not enough to offset the downside risk in owning SBAC at this price.

See Figure 6 for our detailed Stock Rating on SBAC.

Figure 6: SBA Communication's Stock Rating Details: Good Company, Bad Stock

Risk/Reward Rating	Quality of Earnings: Economic vs Reported EPS	Quality of Earnings: ROIC	Valuation: 2 yr Avg FCF (excl cash) Yield	Valuation: Price to EBV	Valuation: Market-Implied GAP
Very Unattractive	Misleading Trend	Bottom Quintile	< -5%	> 3.5 or -1 < 0	> 50
Unattractive	False Positive	4th Quintile	-5% < -1%	2.4 < 3.5 or < -1	20 < 50
Neutral	Neutral EE	3rd Quintile	-1% < 3%	1.6 < 2.4	10 < 20
Attractive	Positive EE	2nd Quintile	3% < 10%	1.1 < 1.6	3 < 10
Very Attractive	Rising EE	Top Quintile	> 10%	0 < 1.1	0 < 3
Actual Values					
SBAC	$6.22 vs. $7.56	12%	3%	3.1	> 100 yrs

Sources: New Constructs, LLC and company filings

More Dividend Training Sessions

After years of digging into Wall Street's accounting tricks, we know firsthand that many so-called "dividend plays" are traps for Main Street investors.

To help investors of any kind avoid these pitfalls, we recently hosted a training showing you exactly how to spot a False Dividend Stock. Watch the replay here.

As a follow-up, we hosted another training discussing the exact topic of this report: Dividend-trap Stocks. You can watch the replay here.

No matter how good the dividend, investing in a bad stock can cost you much more than the dividend pays.

Want to know where to get good dividend stocks? We're hosting a separate live training on June 17 at 1pm ET. In this training, we'll not only cover the dangers of dividends, but also show you which dividend stocks are worth owning. Reserve your spot today.

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Disclosure: David Trainer, Kyle Guske II, and Hakan Salt receive no compensation to write about any specific stock, style, or theme.

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It's Official: We Deliver the Best Fundamental Data in the World

Many firms claim their research is superior, but none of them can prove it with independent studies from highly-respected institutions as we can. Three different papers from both the public and private sectors show:

1. The stock market is missing footnotes – and only we have that critical data.
2. Legacy fundamental datasets suffer from significant inaccuracies, omissions, and biases.
3. Our proprietary drives novel alpha. Our measures of Core Earnings and Earnings Distortion materially improve stock picking and forecasting of profits.

Best Fundamental Data in the World

In The Journal of Financial Economics, a top peer-reviewed journal, Core Earnings: New Data & Evidence proves our Robo-Analyst technology overcomes material shortcomings in legacy firms' data collection processes to provide superior fundamental data, earnings models, and research. More details.

Key quotes from the paper:

- "[New Constructs'] *Total Adjustments* differs significantly from the items identified and excluded from Compustat's adjusted earnings measures. For example… 50% to 70% of the variation in *Total Adjustments* is not explained by *S&P Global's (SPGI) Adjustments* individually." – pp. 14, 1st para.
- "A final source of differences [between New Constructs' and S&P Global's data] is due to data collection oversights…we identified cases where Compustat did not collect information relating to firms' income that is useful in assessing core earnings." – pp. 16, 2nd para.

Superior Models

Ernst & Young features the superiority of our ROIC, NOPAT and Invested Capital research to Capital IQ & Bloomberg's in Getting ROIC Right. See the Appendix for direct comparison details.

Key quotes from the paper:

- "…an accurate calculation of ROIC requires more diligence than often occurs in some of the common, off-the-shelf ROIC calculations. Only by scouring the footnotes and the MD&A [as New Constructs does] can investors get an accurate calculation of ROIC." – pp. 8, 5th para.
- "The majority of the difference…comes from New Constructs' machine learning approach, which leverages technology to calculate ROIC by applying accounting adjustments that may be buried deeply in the footnotes across thousands of companies." – pp. 4, 2nd para.

Superior Stock Ratings

Robo-Analysts' stock ratings outperform those from human analysts as shown in this paper from Harvard Business School. Bloomberg features the paper here.

Key quotes from the paper:

- "the portfolios formed following the buy recommendations of Robo-Analysts earn abnormal returns that are statistically and economically significant." – pp. 6, 3rd para.
- "Our results ultimately suggest that Robo-Analysts are a valuable, alternative information intermediary to traditional sell-side analysts." – pp. 20, 3rd para.

Our mission is to provide the best fundamental analysis of public and private businesses in the world and make it affordable for all investors, not just Wall Street insiders.

We believe every investor deserves to know the whole truth about the profitability and valuation of any company they consider for investment. More details on our cutting-edge technology and how we use it are here.

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