



Which Is Better: A High Yield or a Growing Dividend?

Description

When buying stocks for their dividend growth portfolios, investors will consider several different factors, including the strength of the underlying business, the dividend payout ratio, ratios like price to earnings and price to book values, and potential for the business to grow revenue and profits in the future.

Ultimately, these factors lead to answering the most important question for a dividend growth investor — can this company continue to grow their dividend above the rate of inflation?

In Canada, there are dozens of these types of companies. The big five banks have grown dividends consistently for decades, except a slight blip during the financial crisis of 2009 where their dividends only remained steady. So have our largest telecom companies, a handful of oil companies, and others in various businesses. For the sake of this article, let's focus on three: **Telus** ([TSX:T](#))([NYSE:TU](#)), **TransCanada** ([TSX:TRP](#))([NYSE:TRP](#)), and **Toronto-Dominion Bank** ([TSX:TD](#))([NYSE:TD](#)), which have all grown dividends nicely over time.

We'll compare them to three stocks that have high current yields and not a whole lot of growth, **Rogers Sugar** ([TSX:RSI](#)), **Boston Pizza Royalty Fund** ([TSX:BPF.UN](#)), and **Dundee REIT** ([TSX:D.UN](#)). These are all stable companies with well established businesses, brand recognition amongst their customers, and manageable payout ratios. There's nothing wrong with these businesses except the lack of growth catalysts.

Let's compare the dividends of the two groups of companies. Group A, which I'll call the 'dividend growers' has a current yield of 3.7%, and let's assume they'll continue to grow those dividends 7% per year over time.

Then we have group B, which I'll call the 'high yielders'. They have a current yield of 7.2%. We can assume a little dividend growth over time, but not much. Let's assume they'll grow their dividends 2% a year.

Most dividend growth investors would invest in the dividend growers. They have everything an investor would look for. And, on the surface, I agree with this thinking. But will they really make more money?

Assuming you owned shares in the dividend growers for 10 years, your yield on cost would rise to 7.28%, which is pretty much what you'd be looking for. But, when we compare those results to the high yielders, we see that their yield on cost would have risen to 8.78%. After a decade the dividend growers still haven't caught up. In fact, they don't catch up until year 14, where they never relinquish their lead.

How about how much they pay out over the lifetime of the investment? Assuming each stock doesn't grow in value (a big assumption, I know), it'll take until year 24 before the total value of dividends paid in each group equal each other. That's longer than the investment horizon of many people reading this article. After year 24 it's all gravy for the dividend growers, but it requires a lot of patience.

What does it mean?

This isn't a recommendation to sell all your dividend growing stocks, nor is it a recommendation to blindly buy stocks with high yields and low growth rates. Many stocks with large dividends have high payout ratios and other risks to the business that make a future dividend cut likely.

Instead, why not mix in some high yielding stocks with your dividend growing stocks? You might give up some dividend growth, but gain current dividends today, which can then be reinvested into more shares, giving a bit of a boost to the compound growth machine everyone wants to own.

All dividend stocks deserve a look for your portfolio. Perhaps mixing in a few high yielders could be beneficial, although be careful to avoid those stocks that look like they'll cut that dividend. No dividend investor wants that.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:BPF.UN (Boston Pizza Royalties Income Fund)
2. TSX:D.UN (Dream Office Real Estate Investment Trust)
3. TSX:RSI (Rogers Sugar Inc.)
4. TSX:T (TELUS)
5. TSX:TD (The Toronto-Dominion Bank)
6. TSX:TRP (TC Energy Corporation)

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