Do You Make These 3 Dividend Investing Mistakes?

Description

Here at The Motley Fool Canada, we often talk about the benefits of owning dividend stocks and offer ideas on how to get started.

However, sometimes it's important to explain what *not* to do. Plenty of investors – including yours truly – trip up along the way. So, here is my "top three" list of mistakes dividend investors make, and a handy prescription to cure what ails your portfolio.

1. Do you chase yield?

Many dividend-thirsty investors get seduced by double-digit yields. And in today's income desert with interest rates so low, who can blame them? But believe me, it's just a mirage.

I call them sucker payouts. In my 12-year investing career, nothing signals trouble like a double-digit yield. There are exceptions, of course. But the odds that any one high-yield stock will turn out to be a bargain are small.

Just Energy Group Inc (TSX: JE)(NYSE: JE) is a great example. Many investors were impressed by the stock's 12% yield. But that payout stunk so bad, you would think you were downwind of an outhouse. Sure enough, the gas and energy utility announced a 40% dividend cut in June to conserve cash.

Prescription: Always check the percentage of earnings a firm pays out in dividends — the lower the better. If a company is paying out more cash than what's coming in from the business, it could signal that a dividend cut is on the way.

2. Do you forget about dividend growth?

Some investors skip over a company with a meager yield. I know, because people send me angry emails whenever I tout a stock with a small payout. What they forget is that when you buy a wonderful business, that distribution will grow – along with the share price.

When I try to convert people to the school of dividend growth investing, I like to point out the **Toronto Dominion Bank** (TSX: TD)(NYSE: TD). Sure, the stock has never sported the highest yield. But over the past 20 years, the firm has increased its dividend at an 11% compounded annual clip. If you had bought and held the stock over that time, the yield on your original investment would be over 15% today.

Prescription: Take a look at some smaller yielding names. My favourite dividend growth stocks include **Enbridge Inc**, **Fortis Inc**, and the **Canadian National Railway Company**. None of these stocks have yields that will knock your socks off, but they do deliver reliable growth.

3. Do you forget about diversification?

We have a lot of great dividend stocks here in Canada. The only problem is that they tend to be concentrated in a few sectors like financials, energy, and utilities.

If you're going to rely on your portfolio for income, you can't afford to watch your dividend stream dry up if one sector takes a hit. I speak from experience that when you get too concentrated in one industry, you're going to want to crawl under a rock and die should something bad happen. However, if your portfolio is properly diversified, then you can handle just about anything.

Prescription: For diversification, I recommend adding other sectors like consumer staples and health care. This may require shopping south of the border. The U.S. market has a much better selection of businesses in these industries.

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1. Dividend Stocks
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