How to Invest in Dividend-Paying Stocks and Retire Early

Description

Most people know that buying dividend-paying stocks is a good idea, but there is a way to use the strategy to build a substantial retirement portfolio by investing a little bit at a time.

By using the dividends to buy more shares of the same company, you can take advantage of the power of compounding and watch the portfolio grow. Here's how to do it in the most effective way.

Enroll in the company's Dividend Reinvestment Plan (DRIP)

Many dividend-paying companies allow you to take the dividend payment in the form of new shares, and this is what you want to do.

The process is advantageous because you don't pay a fee to buy the new shares and the purchase happens automatically. If you are just starting to invest and don't have a lot of money available, joining a company's DRIP also allows you to buy partial shares.

If that sounds good, it gets even better. When the shares are issued from the company's treasury, instead of being purchased in the open market, a discount of up to 5% is often applied.

Some companies also have a Share Purchase Plan (SPP) that allows you to buy extra shares without paying any fees. This is a good way to boost your holdings if have a few extra bucks at the end of the month.

Use Your Tax-Free Savings Account (TFSA) or RRSP

If you have a TFSA or RRSP set up in your online trading account, it is best to use it for buying your dividend stocks. This means you get to take full advantage of reinvesting the distributions without paying any tax on them. Setting up the "synthetic" DRIP through the brokerage has the advantage holding the shares in a tax-sheltered account, *but* you don't have the option to buy partial shares, or participate in the SPP.

Using a discount brokerage generally makes sense if the dividend you receive is large enough to buy at least one share. Otherwise, it is better to hold the certificates directly in your name and take advantage of the direct enrollment.

The power of compounding

The idea behind the power of compounding is that your initial investment increases much faster when you use the dividends to buy more shares. Those shares in turn receive dividends, and buy even more shares.

The famous way to illustrate this is using the $1 million or one penny example. If someone offered to give you $1 million today or one penny today but doubled it every day for a month, what would be a better option? The penny. At the end of the month you would have more than $5 million. Don't believe me? Try it on your calculator.

Which stocks should you buy?

This is a buy-and-hold-for-decades strategy. You want to invest in blue-chip companies with a long track record of paying dividends that increase every year. Dividend growth is more important than big yield. It is also best to pick companies that have a competitive advantage in their industry and consistently deliver solid earnings growth.

Banks, utilities, and telecommunication companies have worked well for most DRIP investors and they will probably continue to be the safest bets over the long term. As an example, **Telus Corporation**, (TSX: T)(NYSE: TU), **Toronto-Dominion Bank** (TSX: TD)(NYSE: TD), and **Fortis Inc.** (TSX: FTS) are good picks to start. Some REITs could also be solid candidates.

Telus pays a dividend of $1.60 per share that yields about 3.8%. Toronto-Dominion pays a dividend of $1.88 that yields 3.3%, and Fortis gives shareholders $1.28 that yields 3.2%. Fortis also offers a 2% discount on the shares purchased through the DRIP.

The compounding effect is compelling and disciplined investors can build a substantial portfolio using this strategy as part of a balanced early-retirement financial plan.

If you are looking to set up a retirement portfolio that holds a basket of reliable and proven stocks, the following free report on three more top stocks is also worth reading.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. NYSE:TD (The Toronto-Dominion Bank)
2. NYSE:TU (TELUS)
3. TSX:FTS (Fortis Inc.)
4. TSX:T (TELUS)
5. TSX:TD (The Toronto-Dominion Bank)

Category

1. Dividend Stocks
2. Investing

Date
2025/08/27
Date Created
2014/12/04
Author
aswalker