Why You Shouldn't Buy Any Stock Yielding More Than 6%

Description

If you're looking for some income from your investments, it's not too hard to run a screen for the highest-yielding stocks on the TSX. Of course, it's a lot harder to determine which of these dividends is truly sustainable.

This is the classic tradeoff when you're dividend investing. Do you go for the high yield? Or do you go for the solid, growing payout? The answer can often seem complicated and case-specific.

Well, let me make things a lot simpler for you. If a stock yields more than 6%, just don't buy it. Period. Allow me to explain why, using the past few months as an example.

Some terrible returns

Back in early September, The Motley Fool revealed the top five dividend yields among companies worth at least $1 billion. Since then, those stocks have declined by an average of about 40%.

Allow me to put this in proper perspective. If you had invested your money for 10 years and earned 5% per year, then bought these five stocks in early September, it would have taken only six months for all your investment gains to disappear. If you're looking to save for retirement, or have already retired, is this really the risk that you should be taking?

Not just the oil industry

Two of the top five stocks were decimated by the oil rout**—Long Run Exploration Ltd** and **Lightstream Resources Ltd**. Both of these companies saw their share price decline by about 80%.

That said, the highest-yielding of the five stocks was actually **AGF Management Ltd.**, a struggling asset manager. Since early September, its shares have fallen by about 35%, and its dividend has been cut by 70%. There are plenty of other non-energy high-yielding companies that have fallen on hard times too.

Too much demand

Why have high dividend-paying companies performed so poorly? First of all, these companies are usually facing some sort of headwind. For energy companies, it's declining oil prices. For AGF, it was poor investment performance and declining assets under management.

Meanwhile, these companies are very hesitant to cut their payouts. After all, doing so would send a very negative signal to investors. Here's what makes this dangerous: if the company is facing headwinds, it likely needs that cash. So, sustaining the dividend ends up piling on the financial pressure.

At the same time, there are always plenty of investors willing to hold onto these high-yielding stocks.

Perhaps they're attracted to the high yield, or believe the company can turn things around. Consequently, the company's share price tends not to decline as much as it should.

Just not worth the risk

Right now, there are only two stocks on the **S&P/TSX 60** yielding more than 6%: **Crescent Point Energy Corp.** (TSX:CPG)(NYSE:CPG) and **TransAlta Corporation** (TSX:TA)(NYSE:TAC). Each of them have been managing well in their difficult environments recently, but I still wouldn't buy the shares. If you're looking for a payout you can count on, you'll have to accept a lower yield.

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