Dividend Investors: Why High-Yield Stocks Might Be the Least Risky of All

Description

There are many rules of thumb that have served dividend investors well over the years. For instance, buying companies that have a consistent record of increasing dividends, and focusing on high-quality dividend payers with a demonstrated durable competitive advantage.

One other rule of thumb many dividend investors follow is to avoid high-yield stocks because once a dividend is more than 5%, 6%, or some other arbitrary number, it automatically becomes risky.

While that's true in general, the theory falls apart on a case-by-case basis. There are dozens of high-yield stocks on the TSX Composite that pay sustainable dividends over 5% or 6% annually. Here at Motley Fool Canada, we profile some of these stocks often.

Not only can investors find quality, high-yielding stocks with just a little bit of looking, buying high yield might even be the key to outperformance, provided an investor fully commits to the strategy.

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Using data from the S&P 500, Credit Suisse took a look at the dividend performance of common stocks from 1980 to 2006, separating them out into 10 subsets. Subset one paid the lowest dividends, while subset 10 paid the highest. Here were the results.

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Credit Suisse Dividend Yield Strategy

That's some pretty compelling evidence over a long period of time. Even with all the disasters that inevitably come up with chasing yield, it turns out it's a pretty good strategy.

But I'm not convinced that's good enough. For my portfolio, I want to avoid the inevitable blowups that happen when a high yielder cuts the dividend. The easiest way to do that is to sort by payout ratio.

Credit Suisse did the work on that too, and it turns out it's a pretty effective strategy, at least from 1990-2006.

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Credit Suisse Dividend Yield & Payout

It sure looks like a high-yield/low-payout strategy could be a winner. But identifying the strategy is just one piece of the puzzle; implementing it is another. Here are three stocks that satisfy the high-dividend and low-payout ratio criteria.

Corus Entertainment

Corus Entertainment Inc. (TSX:CJR.B) is one of Canada's largest owners of media assets,controlling television stations like CMT, Teletoon, and Treehouse. The company also owns nearly 40radio stations coast to coast, as well as a company that produces programming for children, Nelvana.

Thanks to the recent CRTC announcement that Canadian cable subscribers will be able to pick and choose channels more easily starting in 2016, Corus shares have plunged nearly 30% so far in 2015. That's pushed the company's generous monthly dividend to a 7% yield.

But going forward, the dividend looks to be pretty secure. Throughout the first six months of the company's fiscal 2015, it's generated $80 million in free cash flow, while paying out only $35 million in dividends. That's a much lower payout ratio than other media giants.

CIBC

Partially because it's now the smallest of the so-called Big Five, shares of **Canadian Imperial Bank of Commerce** (TSX:CM)(NYSE:CM) now sport the highest dividend among its peers at 4.6%. Yet the company only pays out $4.36 per share annually out of net income of $8.78 per share, putting its payout ratio at a very sustainable 50%.

Although the rest of the banks have similar payout ratios, CIBC offers the best dividend. It also offers some interesting new credit card offers, including a partnership with Tim Hortons. It is growing its wealth management business in the United States, and has a very reasonable price-to-earnings ratio under 11.

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Rocky Mountain Dealerships

Rocky Mountain Dealerships Inc. (TSX:RME) owns 38 farm machinery dealerships across the prairies, running under the Case International banner. It's among the cheapest stocks on the TSX, trading at just nine times trailing earnings.

This leads to a very sustainable dividend, even though shares yield 5.3%. The company earned $0.97 per share over the last four quarters, yet only paid out $0.46 per share in dividends. That's a solid payout ratio of just 47%.

One risk of owning Rocky Mountain Dealerships is the cyclical behaviour of the business. Right now, Canadian farmers are doing well, buoyed by strong crop prices and land values. As we all know, good times can't go on forever, and when the good times end, so will some sales of new equipment.

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1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. NYSE:CM (Canadian Imperial Bank of Commerce)
2. TSX:CJR.B (Corus Entertainment Inc.)
3. TSX:CM (Canadian Imperial Bank of Commerce)

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