4 Simple Steps to Build a High-Quality Dividend Portfolio

Description

If your intention is to invest for the long term with minimal maintenance, then one simple way to do that is to build a portfolio with high-quality dividend companies. Then you could theoretically hold the portfolio forever while receiving dividend income that you can either reinvest into your portfolio or use it to pay your bills.

Here are four simple steps to build your very own dividend portfolio.

Step 1: Identify the sectors or industries that provide essential products or services

In these industries, people use their products or services no matter if the economy is doing well or badly. These include utilities, grocery stores, banks, and telecoms.

Step 2: Make a list of high-quality companies from those sectors or industries

For utilities, check out **Canadian Utilities Limited** (TSX:CU) and **Fortis Inc.** (TSX:FTS). Both have paid dividends for over 40 consecutive years. They generate steady cash flows from their operations and therefore pay safe dividends with 3% yields that grow at least 5% per year.

For grocery stores, check out **Empire Company Limited** (TSX:EMP.A) and **Metro, Inc.** (TSX:MRU). They both have paid increasing dividends for 20 years in a row. Compared to the utilities, they pay low yields of 1.3%, but have higher earnings-growth potential and thus have higher income-growth potential.

The biggest Canadian bank, **Royal Bank of Canada** (TSX:RY)(NYSE:RY), pays an above average safe yield of 4% with a sustainable payout ratio of 46%.

For telecoms, **Telus Corporation** (TSX:T)(NYSE:TU) has the highest customer retention rate compared with its peers**.** Further, Telus's 3.8% yield is solid with a sustainable payout ratio of 66%.

Step 3: Periodically review the watch list to see what is priced fairly or at a discount

Periodically, every month or every quarter, review your list of companies to determine which of them are good buys. To eliminate the emotional element as much as possible, you should review your list periodically instead of when there is money is available for investing.

One way to help determine whether or not a company is overpriced is to look at its price-to-earnings (P/E) ratio compared with its historical ratios. For example, Royal Bank's trailing 12-month P/E is 11.8, while it has typically ranged between 11 and 15 in the past. So, Royal Bank seems to be on the cheaper side today.

Historically, Royal Bank also hardly pays over a yield of 4.3%. So, it's getting cheaper as it reaches that yield. Of course, it could very well go over 4.3%. During the financial crisis in 2008-09, it reached the yield of 7.1%! But that was a very rare occurrence.

Step 4: Buy whenever you have excess cash

Excess cash is cash you have left after building an emergency fund and is at least three to six months of your living expenses. The amount that you buy may be based on your transaction fees. For example, if you only want to pay a maximum of 1% for each buy, then you would buy a minimum of $1,000 of shares of a stock based on a $10 transaction fee.

In conclusion

As soon as you start buying quality dividend-paying companies at proper valuations, you start receiving a passive income. Theoretically, you can hold their shares forever as long as their business fundamentals remain intact. You can start with the companies above today.

If you're holding in a TFSA, you won't need to pay any taxes. If you're holding in a non-registered or taxable account, eligible dividends are favourably taxed.

CATEGORY

1. Bank Stocks
2. Dividend Stocks
3. Investing

TICKERS GLOBAL

1. NYSE:RY (Royal Bank of Canada)
2. NYSE:TU (TELUS)
3. TSX:CU (Canadian Utilities Limited)
4. TSX:EMP.A (Empire Company Limited)
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