4 Reasons Dividend-Growth Stocks Can Help You Retire Early

Description

There are very few certain things in the investing world. However, plenty of recent research has shown that if anything is close to being certain, it is this—buying dividend-growth stocks is one of the most effective and low-risk ways to build long-term wealth.

What is a dividend-growth stock? Quite simply, it is any stock that has a consistent record of growing dividends over time. While definitions vary, these stocks generally have a history of growing dividends for five consecutive years or more.

For individuals of all ages planning retirement, a strategy of buying dividend-growth names is an excellent way to steadily generate significant wealth over the long term with much less risk. Here are four reasons why dividend-growth stocks can help you retire early.

1. Dividend-growth stocks outperform stocks with other dividend policies

Over the past 40 years, according to Ned Davis Research, dividend growers in the U.S. **S&P 500** have generated annualized average returns of 10.1%. In this case, a dividend-growth stock is defined as a stock that has increased its dividend in the past 12 months.

How does this compare with other stocks? All dividend-paying stocks returned 9.3%, dividend maintainers returned 7.6%, whereas non-dividend-paying stocks returned a tiny 2.6%. Based on this data, investing in stocks with a record of dividend increases is an easy way to increase your long-term returns.

Even more importantly, a recent study by **JP Morgan** found that 90% of the total returns from the stock market since 1926 can be attributed to dividends rather than movement in the stock price, demonstrating the importance of focusing on them.

2. Dividend-growth stocks have less downside in market crashes

Because companies that provide increasing cash to shareholders are typically healthy businesses with strong fundamentals, and because investors are more motivated to hold on to these stocks during periods of market volatility, dividend growers typically fall much less during market crashes.

During the previous market crash in 2008, the S&P 500 index was down 37% versus the **Dividend Aristocrats Index**, which fell only 21%. The Dividend Aristocrats Index holds stocks that have 25 years of consecutive dividend increases.

The fact that dividend stocks decline less during market crashes, but still participate in bull markets creates a powerful wealth-building effect over time.

3. Dividend-growth stocks are less volatile

In investing, volatility and risk are synonymous. Volatility refers to the degree to which an investment's returns vary over time. According to one measure of volatility—something known as standard deviation—dividend growers have a lower volatility than the S&P 500 as a whole, as well as stocks that either maintain their dividends without growth, or do not pay dividends, according to Ned Davis Research.

This means that dividend growers are generally lower risk than stocks with different dividend policies and the overall market, despite the fact that they generate competitive, and often superior, returns.

4. Dividend growers are often strong and healthy businesses

A strong track record of paying dividends is often an excellent indicator of a healthy underlying business. In fact, it may be one of the best ways to identify a company with strong fundamentals.

In order for a business to grow its dividend in a sustainable way, it requires steady earnings growth, excellent cash generation, and a confident management team that has faith in the company's future earnings.

Typically, businesses that have the ability to grow dividends over time have very predictable earnings, which is often an indicator that the business has some sort of durable competitive advantage.

Canada has several top-notch dividend-growth names

Businesses governed by long-term contracts, in regulated industries and with limited competition, often make great dividend payers. For this reason, pipeline and infrastructure stocks offer great opportunities.

Enbridge Inc. (TSX:ENB)(NYSE:ENB), for example, has increased its dividend every year since 1996, and plans on growing its dividend by 14-16% annually for the next four years.

Brookfield Infrastructure Partners L.P (TSX:BIP.UN)(NYSE:BIP) is committed to annual long-term dividend growth of 10%, which is possible thanks to the stable utility and transport assets it owns.

CATEGORY

1. Dividend Stocks
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