3 Reasons to Focus on Dividend Investing

Description

Too many investors discount the value of dividends. They're more concerned with chasing capital gains to the detriment of their prospects of achieving success in investing. What they fail to realize is that dividends are a powerful tool for enhancing returns and reducing risk in any stock portfolio.

Let me explain.

Now what?

Firstly, dividends enhance returns.

Research from ratings agency Standard & Poor's indicates that dividends have made up around 40% of the total returns generated by the **S&P/TSX Composite Index** between 1956 and 2013. Despite capital gains making up the majority of the returns generated by the index, the chunk made up of dividends is just too big for investors to ignore.

It is also worth noting that dividends that are classified as eligible dividends (which means they are paid out of taxed corporate profits) receive favourable tax treatment, making them a form of tax-effective income.

Secondly, by investing in dividends investors are able to reduce risk.

This is because companies that have a track record of consistently paying sustainable, regularly increasing dividends are engaged in relatively stable and predictable businesses. Not only does this mean they have track records of stable earnings, but they are more resilient to economic downturns.

Bank of Nova Scotia (TSX:BNS)(NYSE:BNS) has paid a dividend in one form or another for well over a century, and, after hiking its dividend ever year for the last five years, now has a juicy 5% yield. Another example is electric utility **Canadian Utilities Ltd.** (TSX:CU). Not only does it offer investors a tasty 4% yield, but it impressively has hiked its dividend every year for 44 years straight.

Regular dividends also provide investors with a greater degree of flexibility because they provide a regular income stream regardless of how the company's stock price performs. As a result, they will continue to reward investors even if the company's stock tanks due to macro events beyond its control.

This is of particular importance for income-focused investors because it means there is no need for them to sell shares in order to generate income, which in the case of a market rout could see them crystallizing significant losses.

Finally, dividends offer superior yields compared to traditional income investments.

Compared with traditional income investments such as bonds or guaranteed income certificates (also known as GICs), dividends offer investors a far superior yield. The S&P/TSX Composite Index has an average dividend yield of just over 3% compared to the 1.25% offered by 10-year Canadian government bonds and the 0.5% to 2.5% offered by GICs.

Both Bank of Nova Scotia and Canadian Utilities pay dividends with significantly higher yields than government bonds or GICs, as does Canada's largest telco **BCE Inc.** (TSX:BCE)(NYSE:BCE).

BCE has a long dividend-payment history. It has paid a dividend since 1949 and hiked it for the last seven years, giving it an impressive 5% yield. It has been able to do this because of its solid economic moat and steady earnings growth.

So what?

Dividends are an important means of enhancing returns and reducing risk for investors. Not only do they provide a handy income stream, but they deliver a superior yield to most fixed-income investments. Blue-chip companies such as Canadian Utilities, Bank of Nova Scotia, and BCE offer investors juicy yet sustainable dividend yields that will continue no matter the state of the economic cycle.

CATEGORY

1. Dividend Stocks
2. Investing

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1. NYSE:BCE (BCE Inc.)
2. NYSE:BNS (The Bank of Nova Scotia)
3. TSX:BCE (BCE Inc.)
4. TSX:BNS (Bank Of Nova Scotia)
5. TSX:CU (Canadian Utilities Limited)

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