How to Strategically Use High-Income Stocks

Description

High-income stocks pay above-average yields compared to the market. The **iShares S&P/TSX 60 Index Fund** (TSX:XIU), which represents the Canadian market, yields 3.04%. So, a high-income stock would be one that yields 1.5 times higher than that yield–a yield of 4.56% or higher.

The strategy

Before buying high-income stocks, it should be determined that their high yields are safe. Otherwise, the strategy will break apart.

The total return of an investment consists of capital gains and dividends. Capital gains aren't realized until you sell. By pocketing a high income, investors can use that cash to invest in high-growth companies, such as **Facebook Inc.** and **Alphabet Inc**.

Over the long term, share prices will head higher if businesses become more profitable over time. On the other hand, dividends are paid out from cash flows or earnings. So, companies with stable, growing earnings and cash flows are best for a high-income strategy.

By buying high-income stocks when they're priced reasonably or, even better, at discounts, investors can hold on to the shares forever to boost their cash flows.

Alaris Royalty

Alaris Royalty Corp. (TSX:AD) provides cash financing to North American private businesses with proven track records of stability and profitability in changing economic environments. Alaris partners with these businesses for the long term. In exchange, it receives monthly cash contributions from them.

Every year these distributions are adjusted based on the year-over-year percentage change in a top-line performance metric, such as net sales, gross profit, or same-location sales. If these businesses do well, so will Alaris.

In March, Alaris's cash flow is sourced from 16 revenue streams. However, the top two sources contribute 30.6% of its revenue streams; 67% of the revenue stream is from the U.S., while 33% is from Canada. So, Alaris also benefits from a strong U.S. dollar.

Alaris has raised its dividend for eight consecutive years. In the past five years, it averaged dividend increases of 10.6% per year. Its dividend is 8% higher than it was a year ago.

At under $29 per share, Alaris Royalty yields 5.6% with a payout ratio of about 88%. Historically, its partner revenues have experienced organic growth of 1-5% per year. This implies a total return of 6.6-11.6%, and investors can also expect its dividend to grow at least 1-5% per year.

Other sources of high income

Real estate investment trusts (REITs) collect rental income from the many properties they own, operate, and manage. Many REITs generate high income of over 8%.

For example, **Slate Office REIT** (TSX:SOT.UN) invests in non-trophy Canadian office properties, which it finds more attractive than trophy assets.

It yields a juicy 9.5%! It last reported a payout ratio of 96% in the fourth quarter of 2015, which was a big improvement from its 2014 payout ratio of 124%.

Conclusion

By holding a basket of safe, high-income companies, investors can use that income to invest for high growth. Ensure that you buy high-yielding companies when they're priced at reasonable valuations because the higher their yields, the slower they tend to grow.

Alaris is a stronger buy at the $26 level or lower, and Slate is a stronger buy when it's close to $7.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. TSX:AD.UN (Alaris Equity Partners Income Trust)
2. TSX:RPR.UN (Ravelin Properties REIT)
3. TSX:XIU (iShares S&P/TSX 60 Index ETF)

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