Why You Shouldn’t Discount 4% Yields

Description

I recently read a comment that gave me some food for thought. The comment was about **Bank of Nova Scotia** (TSX:BNS)(NYSE:BNS) and said that in the last 10 years, it hasn’t been able to outperform the market, so there’s no point in considering it as an investment.

In the last decade the bank’s annualized rate of return was 7%, which is considered market performing. However, investors shouldn’t discount Bank of Nova Scotia or other stable dividend payers that yield more than 4% and continue to grow their dividends.

There’s no replacement for income

Just looking at today, Bank of Nova Scotia yields 4.4%, the **SPDR S&P 500 ETF Trust** (NYSEARCA:SPY), which represents the U.S. stock market, yields 2.6%, and the **iShares S&P/TSX 60 Index Fund** (TSX:XIU), which represents the Canadian stock market, yields 2.9%.

So, an investment in Bank of Nova Scotia generates 69% more income than an investment in the U.S. stock market and 51% more income than an investment in the Canadian stock market.

There’s no replacement for income. If your monthly phone bill is $60, an annual cost of $720, you can’t pay less than that. To generate $720 of dividends from a 4.4% yield, you need to invest $16,364.

Unfortunately, our supply of money is limited. So, we have to choose where to invest our money. If generating that $720 of annual income is essential, then you’ve got to look for investments with high enough yields.

Income generation comparison

If you had invested $10,000 in Bank of Nova Scotia in November 2006, you would have generated $4,241 of income so far.

The same amount invested in the S&P 500 would have generated $2,150 of income. So, the bank generated 97% more in income in that period.

What's your goal?

Investors need to ask themselves why they're investing. Do you want income now? Or are total returns more important?

In different stages of your life, your goals will likely shift. Retiree investors probably want sufficient income to pay the bills today. That income should also be growing to at least keep pace with inflation.

Bank of Nova Scotia is a good candidate for that. It offers a 4.4% yield, and from the fiscal years 2010 to 2015 it hiked its dividend at an annualized rate of almost 6.8%, which more or less doubles the rate of inflation.

Younger investors who have a longer investment horizon might instead invest in high-growth stocks, such as **Nike Inc.** (NYSE:NKE), which is expected to grow its earnings per share (EPS) at a rate of roughly 15%. Comparatively, Bank of Nova Scotia is expected to grow its EPS by about 7%.

Conclusion

Investors should recognize that Bank of Nova Scotia and Nike are very different investments that play different roles in a diversified portfolio.

Bank of Nova Scotia pays a juicy dividend of more than 4% by paying out half of its earnings. It's a stable, high-yield, dividend-growth stock.

Nike pays a small yield of about 1%, which is expected to grow at a double-digit rate in alignment with its earnings growth. Most of Nike's returns are expected to come from a rising share price over time.

Nike is a high-growth, dividend-growth stock with higher risk because it trades at a higher multiple and there's no way of knowing if it can achieve its high double-digit earnings growth.

CATEGORY

1. Bank Stocks
2. Dividend Stocks
3. Investing

TICKERS GLOBAL

1. NYSE:BNS (The Bank of Nova Scotia)
2. NYSE:NKE (NIKE Inc.)
3. TSX:BNS (Bank Of Nova Scotia)

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