Young Investors: Are Dividend-Growth Stocks Safer Bets Than a House Right Now?

Description

Canadians have successfully used their homes as forced-savings vehicles for decades, but that party might be over.

Why?

House prices are now at nosebleed levels, and the government is concerned about the long-term impact household debt might have on the economy.

As a result, Ottawa is putting measures in place to slow down the runaway train.

On top of that, the 30-year bull market in bonds might be at an end, and that means fixed mortgage rates are probably headed higher from this point forward.

We are already seeing how quickly things can change; Canada's two largest banks raised mortgage rates last week in response to tighter rules and weaker bond prices.

What's the risk?

The government has probably waited too long to cool down the housing market and will be forced to put more restrictions in place to keep ballooning household debt from sinking the economy.

Evan Siddall, the head of Canada Mortgage and Housing Corp. (CMHC), recently said he is considering raising the minimum down payment requirement for mortgages insured by the Crown corporation.

CMHC is also looking at options to force the banks to take some of the hit on loans that go bad. For the moment, CMHC provides a 100% guarantee to the big banks.

The banks are simply going to pass on any added risk to homeowners in the form of higher rates. If CMHC implements the new measures just as inflation ramps up and the bond market tumbles, the resulting jump in mortgage rates could be significant enough to set off a serious tumble in house prices across Canada.

The last time a housing bubble burst in this country, it took 15 years for people to get back to a breakeven point on the value of their homes.

Should you buy dividends stock instead of a house?

Betting on the house to fund retirement is no longer a sure thing, so it is worthwhile for young investors to consider other options.

One popular method is to buy dividend-growth stocks and use the distributions to purchase additional shares. With the arrival of the Tax-Free Savings Account (TFSA), Canadians can now reinvest the full value of the dividends and keep all of the capital gains when the time comes to cash out the portfolio.

Which stocks should you buy?

The best names tend to be market leaders in industries that are reasonably protected from new entrants.

Let's take a look at **Canadian National Railway Company** (TSX:CNR)(NYSE:CNI) as an example.

CN is the only North American rail operator that can provide access to three coasts. That competitive advantage is probably safe because mergers in the sector tend to run into regulatory roadblocks, and the odds of new competing tracks being built along the same routes are pretty much nil.

CN still has to compete with trucking companies and other rail lines on some of its routes, but transport options for goods are not going to change. It's either trains, boats, planes, or trucks.

Management is among the best in the sector, and the executive team is always fine-tuning the business to improve efficiency. As a result, CN generates significant profit, even during times of economic weakness.

Returns?

CN has a compound annual dividend-growth rate of about 17% over the past two decades.

A single $30,000 investment in CN 20 years ago would now be worth more than $1 million with the dividends reinvested.

There is no guarantee that the next 20 years will generate the same return for CN investors, but young people who are chasing the housing market today might want to consider putting their down payment into top dividend-growth stocks instead.

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2. Investing

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1. Editor's Choice

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