3 Reasons Why Dividends Are an Investor's Friend in a Volatile Market

Description

One of the easiest paths to investing success is by investing for the long term in companies that pay a regular and growing dividend. Not only are investors able to build a steadily growing income stream, but dividends can be an important means of managing volatile markets during times of uncertainty.

Now what?

Firstly, those companies that have a long history of regularly growing dividend payments typically have steady cash flows and solid financial health.

This is because they commonly have wide economic moats and established businesses that are resilient to economic downturns. An example of this is **Fortis Inc.** (TSX:FTS)(NYSE:FTS). As an electric utility, it operates in a heavily regulated industry with steep barriers to entry, which protects it from competition.

Then there is the inelastic demand for electricity, meanings that its earnings remain stable and relatively immune from downturns in the economy.

As a result, Fortis has rewarded investors with 43 years straight of dividend hikes that now see it yielding a juicy 4%. That is far more than many supposedly lower-risk assets typically associated with income investing, such as government treasury bonds.

Secondly, dividends force management to operate with greater discipline and focus on a company's future performance.

Studies have shown that the greater the amount of cash a company holds, the more likely management is to engage in behaviour that damages shareholder value, such as overpaying for acquisitions.

There is also the impact that dividend cuts can have on a company's share price, meaning that management focuses on growing the business to improve the sustainability of cash flows and ensure the security of the dividend. This makes management focus on correctly positioning the business so as to allow it to weather economic uncertainty and sustain earnings.

Finally, even if stocks fall sharply, dividends still allow investors to earn a return.

This is a particularly important attribute for those investors who are dependent on generating income from their portfolios. It means that during market downturns, they are not forced to sell stocks and crystallize loss in order to generate income. Not only can investors continue to generate a return from their investments, but they are left well positioned to benefit when the market rebounds.

For those investors that don't require the income dividends provide, they can reinvest those dividends.

When stocks fall in value, they can acquire more stock at a discount, thereby reducing their cost base, without having to invest any of their own capital. It is here that investors benefit from the principle of compounding, which further enhances their returns.

This becomes apparent when considering the returns of **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD) over the last 10 years. Had an investor over that period taken the dividends as cash, they would have received a return of 133%, but had they reinvested the dividends, that return would have been 172%, or almost 40% higher.

So what?

Despite the naysayers among market pundits who claim dividends are bad, the benefits they offer investors are obvious. Not only do they allow investors to build a regular income stream, but they also help to reduce uncertainty during volatile markets, and they enhance returns, making them an important tool for achieving investing success.

CATEGORY

1. Dividend Stocks
2. Investing

POST TAG

1. Editor's Choice

TICKERS GLOBAL

1. NYSE:FTS (Fortis Inc.)
2. NYSE:TD (The Toronto-Dominion Bank)
3. TSX:FTS (Fortis Inc.)
4. TSX:TD (The Toronto-Dominion Bank)

Category

1. Dividend Stocks
2. Investing

Tags

1. Editor's Choice

Date
2025/10/01
Date Created
2016/12/08
Author
mattdsmith