# Income Investors: Don't Go Chasing High-Yield Stocks. Do This Instead

## Description

As the new year comes around the corner, many investors are looking to rebalance their portfolios by trimming winners, dumping losers, or adding more dividend-paying names to their TFSA. I love dividends, and if you're in it for the long term, then you can expect dividends to account for a huge chunk of your returns many years down the road.



While it seems like a great idea to pick up stocks that yield 6% or more, this is rarely a good strategy, because these are usually stocks known as having "artificially high yields." These artificially high yields come about because the stock experienced such a big sell-off that the dividend yield jumped to an unstable–and most likely unsustainable–level. If the yield is substantially higher than 6%, then you could be looking at large capital losses to go with your reduced dividend yield down the road.

Foolish investors should avoid stocks which have yields above 6% because it's likely something went horribly wrong in the business, and usually a dividend cut is close to follow.

If you take a close look at the cash flow statements of these businesses, then you will see that a lot of the time the cash flow coming in for a particular quarter is barely enough to pay the dividend. This limits the company's ability to reinvest, and it's usually a much better idea to just reduce the dividend than it is to keep it.

For my TFSA dividend portfolio, I have one simple rule: "Don't go chasing waterfalls. Stick to the rivers and the lakes that you're used to."

It's a great lyric to a 90's hit song, but it also applies to chasing high-yield dividend stocks. The waterfalls are the artificially high yielders, and the rivers and the lakes are stocks paying less than 6% with ample free cash flow and a moat.

The trick is to keep the yield of your high-dividend stocks at under 6%, but above 3%. This is the sweet spot, where the dividend is sustainable and the company still has the ability to grow. Usually, the stock is facing a temporary sell-off and will enjoy upside in the medium term once the company gets back on its feet.

This is how you build an incredible income portfolio that will give you capital gains and a high yield. You buy stocks of wonderful businesses that are priced at a discount–not cigar butts that will offer you the largest yield. This is short-term thinking, and it's not recommended for Foolish investors.

If your strategy is to run a screener for the highest dividend yields on the TSX, then you'll quickly realize this is a strategy for losing your shirt; it's no different than catching a falling knife. But in this case, you'd be catching a falling knife while chasing a fleeing dividend.

One stock that is in the sweet spot right now is **Telus Corporation** (TSX:T)(NYSE:TU). The stock has been flat for two straight years, but it could be ready to explode higher in 2017. The stock yields a bountiful 4.6%, which is very sustainable, and it has an almost zero percent chance of ever being cut, even if a recession happens. The business is very stable, and the cash flow will sustain future dividend raises as well as further investment in its infrastructure.

The stock has been a big loser in 2016, but it has a wide moat and a fat dividend which is likely to grow. So if you're looking for an undervalued, high-yielding gem to add to your income portfolio, buy shares of Telus–not a random stock yielding 9%. Chances are you'll never see that 9% yield paid out for a given year.

Telus is ridiculously cheap and remains one of my favourite high-yielding stocks for the long run. If you're a patient income investor with a long-term horizon, then collect the dividend as you wait for the stock to become a winner again.



Remember: don't go chasing yield, and you'll get very rich in the long run.

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