Why Dividend Stocks Are Set to Shine in 2017

Description

The world economy has experienced a period of low inflation in the last decade. This has allowed monetary policy across the globe to become exceptionally loose as Central Banks have sought to stimulate economic growth in order to avoid a depression after the Financial Crisis.

While this policy has not created higher levels of inflation due to the global economy having faced a deflationary cycle, the situation could be about to change. Higher levels of inflation may be on the way and dividends could therefore become increasingly important for investors across the world.

Policy change

A key reason why inflation could rise is policy change in the US. As the world's largest economy, its performance matters greatly to the outlook for the global economy. Therefore, Donald Trump's plan to increase spending on infrastructure and defence, while at the same time reducing taxes, could lead to higher levels of inflation for all investors. A policy of that nature would be likely to increase the US budget deficit, as well as the national debt, with higher inflation being the probable result.

Of course, higher levels of inflation generally mean that interest rates will rise. That's because policymakers will usually seek to cool higher inflation by making saving more attractive and spending less so. However, in the case of the US, recent data on employment figures suggests the Federal Reserve may be somewhat limited in their scope to raise rates quickly during the course of the year. This could allow inflation to move higher than it otherwise would.

Dividend shares

If higher US inflation is exported across the globe, it could create a situation which many investors have not experienced in more than a decade. The real yields on shares and major indices could turn negative, while the interest on cash balances and bond yields may offer little appeal as inflation eats away at its value.

In such a situation, higher-yielding stocks could become more popular. A 5% or 6% yield has a much better chance of protecting the real-terms value of an investor's holding than a 2% or 3% yield does. Therefore, demand for the biggest yields could rise during the course of the yield, leaving holders of dividend shares sitting on relatively high profits. This also means that now could be the right time to buy higher-yielding shares, since their yields will fall if their share prices rise on the back of increasing demand from investors.

Clearly, higher rates of inflation could prove to be more than a one-off. They could be here for a number of years. As a result, buying shares which offer dividends which can grow at a faster pace than inflation may also be a prudent move. Although higher rates of inflation are not guaranteed, policy change in the US seems inevitable under the new President. As such, now could be the right time to buy dividend stocks for the long term.

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