Should You Focus on Yield or Growth?

Description

For the context of this article, we'll assume that the dividend yield implies a 3-5% yield and that the stocks with this yield are growing their dividends by roughly 5-8% a year. That is, their dividend-growth rates are more than keeping up with inflation. As such, these types of stocks are suitable for buying to help pay the bills.

We'll also assume that the dividend growth implies annualized growth of 15% or more.

Whether you should focus more on dividend yield or dividend growth depends on your answers to the following questions.

Do you need income right now?

If you need the income from a 4%-yield portfolio to pay the bills or for other things, such as a vacation, you can't replace it with 2% yielders that have higher growth prospects and implied higher total returns estimations.

Do you want less-volatile stocks?

Typically, stocks with decent yields and growing dividends tend to have strong support around a specific dividend-yield level. In the uncommon case that the stock price falls through that level, it'll eventually return to that support as long as the company continues to hike its dividend.

I'll use **TransCanada Corporation** (TSX:TRP)(NYSE:TRP) as an example. In the last five years, it has had pretty good support at about a 4% yield — thanks partly to its track record of dividend growth.

It's uncommon to see the dividend-growth star of 16 consecutive years offer a yield significantly higher than 4%.

The energy sector scare caused the shares to fall and, as a result, TransCanada yielded as high as5% last year. However, that rare opportunity didn't last for long. The shares have had an excellent runsince 2016 and offer a 4% yield today right at the support level.

As long as TransCanada continues to hike its dividend (and management has guided it will continue growing the dividend by 8% per year through 2020), the 4%-yield support should remain intact.

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Do you have a long investment horizon or do you want higher total returns?

If you have a long investment horizon of, say, five or more years, and the amount of income generated is not important to you at the moment, you may choose to aim for higher total returns. However, you may still wish to stick with dividend-growth stocks.

In that case, you can invest in faster-growing dividend-growth stocks that tend to offer smaller yields but faster dividend growth.

I'll use **Alimentation Couche Tard Inc.** (TSX:ATD.B) as an example. In the last five years, although it only ever reached the highest yield of 1%, the shares returned 530% in that period!

That's an annualized return of 44.5%, which handily beat average market returns of 10%. In the same period, its dividend more than tripled. The amazing share price appreciation and dividend growth were attributable to Couche Tard more than quadrupling its earnings on a per-share basis.

Not only can fast-growing dividend-growth stocks deliver outstanding returns, but they can also boost your dividend income significantly for the future.

Investors should be warned that there's a risk with high-growth stocks — when their growth slows down, their multiples will likely contract and can cause their share prices to fall. This shouldn't deter you from investing in high-growth stocks altogether, though, especially, if you hold a basket of them.

Investor takeaway

For different reasons, investors may invest in stocks that offer yields of 3-5% and dividend growth of 5-8%, and high-growth stocks that raise their dividends at double-digit rates.

However, if you don't have a clear "yes" for the first two questions above, then there's nothing stopping you from owning high-yield stocks such as TransCanada and high-growth stocks such as Couche

Tard, as long as they’re quality businesses. Certainly, these two are quality names to own for the long run.

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