Why Income Investing Is Vastly Underrated

Description

Buying income stocks is often viewed as a rather boring investment style. After all, a key reason many investors buy shares is to generate capital growth. Certainly, a 5% yield may be better than many bank accounts or bonds offer. However, given the risks involved with investing, many investors would argue that it is an insufficient return. This view, though, could be missing the point of income investing. Indeed, it could be a lot more profitable than many investors realise.

Return potential

Dividends may provide an income return for their investors, but they also provide an insight into the financial health of a company. A fast-growing dividend indicates a company is financially sound and, perhaps even more importantly, that its management team is confident in its future outlook. This could indicate that rapid earnings growth is on the horizon. This could cause investor sentiment to improve, since the stock market usually rewards companies which are able to deliver above-average bottom line growth.

In addition, a dividend which is growing at a brisk pace may prove particularly useful in 2017. Inflation across the globe is likely to rise as President Trump’s spending plans may mean a higher rate of inflation in the US is exported elsewhere. Dividend growth could make the difference between a positive and negative real-terms return for investors this year. As such, demand for dividend shares could rise and lead to them recording high capital gains.

Lower risk

Dividend shares are also generally viewed as relatively lower risk stocks to own. This may be because they usually operate in sectors such as utilities and tobacco, where revenue and profitability is more consistent than in other, cyclical sectors. The defensive characteristics of dividend shares mean they offer lower risk profiles than most shares, which could make them more attractive based on the risk/return ratio.

Certainly, the potential for market-beating gains may be lower, but their losses during challenging years for stock markets may mean their total returns in the long run are superior to those of higher risk, cyclical stocks. This point could be extremely relevant in 2017, when the global economy is expected to endure an uncertain year. Policy changes in the US and a lack of clarity regarding the future of the European economy in particular could mean that investors adopt an increasingly risk-off attitude. Dividend stocks could become increasingly in-demand, which may make their capital gains relatively high this year.

Long-term outlook

Various studies have shown that the reinvestment of dividends generates a large proportion of total returns in the long run. Therefore, buying income stocks could boost your portfolio returns. Dividend shares also offer defensive characteristics and rapidly-rising dividends could even signal future earnings growth as they act as a proxy for management confidence in a company's outlook. As such, while dividend stocks may not seem to be particularly exciting, they may be worth seeking out in the long run.

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