



Why These Dividends Are the Most Valuable

Description

For many investors, income investing is all about obtaining the highest return possible. As such, a stock which yields 6% would generally be viewed as being a superior dividend stock when compared to a company which yields 4%. While this may be true when all other things are equal, the reality is that higher yields often come with higher risk. Therefore, it could be worth focusing on companies with lower yields and lower risks in order to obtain the highest return in the long run.

The right business model

Much of the risk involved in income investing comes down to the business model of the company in question. If the business model generally offers stability, modest growth each year and impressive levels of earnings visibility then the chances of receiving a payout in the form of a dividend are relatively high. Similarly, a company which has earnings that are relatively volatile and which operates in a cyclical industry is more likely to struggle to pay dividends at their current level during leaner years.

As such, it is logical for investors to ascertain whether a company can realistically afford and maintain its current level of dividend. Certainly, checking its payout ratio is a sound starting point. However, this provides only a snapshot of the situation in a given year. Since many income investors focus on the long run, it is prudent to consider whether dividends can easily be paid even if the wider industry or economy endures a prolonged downturn.

Dividend growth

As well as considering the risks involved with dividend payments, growth potential remains central to successful income investing. A high yield may be attractive today, but if the company in question will be unable to raise shareholder payouts in future then investor sentiment could decline. This may offset any high income return, especially at a time when global inflation could be set to rise.

In fact, if President Trump's higher spending and lower taxation economic plan causes higher inflation to be exported across the globe, investors may value inflation-beating growth above higher yields. This would represent a step-change in their standpoint of the last decade, when an era of global

deflation/low inflation has kept dividend growth rates off most people's radars. As such, focusing on a company's ability to not only afford its dividend payments, but to also grow shareholder payouts by at least as much as inflation may become crucial to income investors.

The ideal sectors

Given the importance of risk, dividend growth and a high yield, it is possible to rule out a wide range of sectors in order to find the best types of dividend shares. Defensive stocks operating in the tobacco, beverages and consumer goods sectors where customer loyalty is high could prove to be among the most attractive income shares. Likewise, utility stocks may also offer low risk, high yields and inflation-beating dividend growth.

While the stocks operating in these sectors may not have the highest of yields, their track record of paying out progressively higher dividends may be strong, while their pricing power may mean that their shareholder payouts beat inflation in future years. As such, they are likely to be among the most valuable income stocks on offer.

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Date

2025/08/27

Date Created

2017/03/27

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