When Reinvesting Dividends Boosts Your Gains

Description

One of the greatest findings in history is compounded returns. That's getting your money to work for you, so your hard-earned savings can earn you more money.

Here's a simple example: you stock away, say, $10,000 in your savings account, and you earn 1% of interest a year. In year one, you earn $100. In year two, you earn $101 on the $10,100, assuming the interest rate stays the same and you leave the $10,100 alone in the account.

You can imagine that the higher the rate of return you can earn on your investments, the faster your money will grow. Here's when reinvesting your dividends can help you boost your gains.

I'll illustrate with a couple of examples.

BCE Inc. (TSX:BCE)(NYSE:BCE) is popular among dividend investors for its big dividend, which comes to a yield of 4.7% today. If you had invested $10,000 in BCE at the start of 2008, you would have gotten $4,663 of dividends and an annualized rate of return of 7.8%.

This beat investing in a broad market index, using **S&P 500** as a proxy, which would have generated less than $2,000 of income and an annualized rate of return of 6.6%.

What if you had reinvested the dividends? Your BCE investment would have returned 9.8% per year, and the S&P 500 investment would have returned 7.5% per year.

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dividends

CCL Industries Inc. (TSX:CCL.B) has been the talk of the block lately. Like BCE, CCL Industries is a dividend-growth stock, but more of the spotlight has been on its growth than its dividend.

If you think its run-up of nearly 29% in the last 12 months is impressive, you'll be wonder-struck by its five-year performance: it has appreciated more than 700%! And I haven't even factored in its dividend growth yet.

Let's stick to comparing the investments starting from 2008. A $10,000 investment in CCL industries would have generated $2,267 of dividends and an annualized rate of return of 24.9%.

What if the dividends were reinvested? The investment would have returned 26.5% per year.

Investor takeaway

In the BCE case, by reinvesting dividends, you got 2% more returns per year. In the CCL Industries case, you got 1.6% more returns per year.

Both cases worked because the shares were trading at a higher price at the end of the defined period compared to the start of the period. In order for reinvested dividends to boost your gains, shares must trade higher.

Temporarily depressed shares seem to hurt your returns. In reality, the cheaper shares will boost your long-term returns if you choose to reinvest your dividends in the stock and if the stock ends up trading higher over time.

BCE's shares were temporarily cheap, trading at a multiple of 10-11 in 2008 and 2009, which was partly due to the recession and the talks of privatization at the time. Buying BCE at about $25 per share in early 2009 would have delivered an annualized rate of return of 15.1% without dividend reinvestment and 17% with dividend reinvestment.

At any time, the hard part is deciding if shares are temporarily depressed or not.

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1. Dividend Stocks
2. Investing

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2. TSX:BCE (BCE Inc.)
3. TSX:CCL.B (CCL Industries)

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