This Could Drive Dividend Stocks Higher in 2017

Description

The world economy has always moved in cycles. Just when it seems as though the stability has been established, things change and the cyclicality of the business and economic world becomes apparent.

This is highly relevant at the present time since the global economy has become somewhat used to deflation. After all, it has been in a deflationary cycle for a decade. Now, though, inflation could be ahead. And it may make dividend shares more popular and push their share prices higher.

Rising inflation

Higher levels of inflation appear to be likely due to policy action in the US. One of the key tenets of Donald Trump's Presidential campaign was his pledge to increase spending in the US. Although he has perhaps not been able to put this promise into practice as quickly as had been suggested, he still appears to be focused on boosting spending on infrastructure and defence. Doing so is likely to lead to higher levels of inflation which could be exported around the globe.

At the same time as higher spending, President Trump intends to cut taxes. While this may not fully filter through into higher levels of spending, it is likely to create at least a degree of inflationary pressure. Coupled with the Federal Reserve's apparent caution when it comes to raising interest rates in response to higher inflation and the potential for time lags, the end result could be higher inflation.

The effect on investors

Clearly, many investors value dividends and the income return above inflation which they can potentially generate. In recent years, the ease of beating inflation has been somewhat surprising. However, since stock markets are now relatively high on a global basis and inflation may creep higher, it may become more challenging for investors to generate an income return which beats inflation.

As a result of this, dividend shares offering a yield which is above inflation may become increasingly popular. This could push their share prices higher and also offer some support should the global economic outlook deteriorate. In other words, the share prices of generous dividend-paying shares which are able to grow shareholder payouts at a rapid rate may have a ‘floor’ which prevents their yield from moving to a level which is significantly higher than inflation.

Foolish Takeaway

Clearly, there is the potential for higher inflation on a global scale. In such a scenario, holding dividend shares could be a worthwhile investment strategy. However, there could also be a scenario where investors consider higher inflation to be a long-term situation. This may mean that companies which are able to raise dividends at an inflation-beating pace are given preference to more ‘traditional’ income stocks that may have high yields, but low-single digit dividend growth rates.

As such, seeking a mix of a high yield and dividend growth could be the optimum means for Foolish investors to overcome the threat of rising inflation in the long run.

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