Do You Own Enough Dividend Stocks?

Description

Deciding how many shares to own within an income-focused portfolio is never easy. To a large extent, it depends on an individual investor's personal circumstances and risk tolerance.

For example, an investor with a requirement for an income return and low risk tolerance, for example during retirement, may need to own more stocks in order to generate a more stable return. Likewise, an investor with a higher risk tolerance and less need for a steady income may be able to cope with a more concentrated portfolio.

However, there are a number of sensible steps which all investors can take in order to maximise the risk/return ratio from their portfolio of dividend shares.

Worthwhile diversification

While holding more stocks can reduce company-specific risk within a portfolio, a higher number of shares held does not necessarily mean lower overall risk. That's because in a lot of cases dividend shares are rather similar in terms of the industry in which they operate, their balance sheets and life-cycle stage.

For example, many dividend shares tend to be mature companies which do not require high levels of reinvestment. Therefore, they are able to pay out a sizeable proportion of their earnings as dividends. While this can often equate to relatively high yields, it also means they sometimes offer relatively low dividend growth rates.

In the current climate of low inflation and low interest rates, this is not a major problem as even slow-growth stocks generally beat inflation when it comes to increases in dividends. However, if inflation picks up, holding too many mature stocks could lead to a decline in real-terms income growth.

Debt and industry variation

Similarly, many dividend shares have high debt levels. This stems mostly from their mature status and stable cash flow. However, holding shares in too many highly-indebted companies can mean an investor faces considerable interest rate risk which could harm their overall returns.

The same principal applies to industry diversity. Many income shares operate in sectors such as utilities, tobacco and other relatively stable industries. While this gives them defensive qualities, it can also mean their growth rates and share price gains lag the wider index during boom periods. Therefore, it could be prudent for investors to focus on holding a range of stocks from a variety of sectors and industries.

Concentration level

Of course, diversification is worthwhile only to a certain extent. If a portfolio becomes overly diversified then it is possible its returns will differ only marginally from the wider index, with commission costs likely to impair performance versus a tracker fund. Furthermore, the larger the number of shares held within a portfolio, the more challenging it is to track their progress.

As such, the optimum number of shares in an income portfolio may be less than many investors believe. However, obtaining worthwhile diversification in terms of industry, balance sheet strength and dividend growth potential could be a more worthwhile pursuit for investors seeking to generate the most enticing risk/return ratio for the long run.

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