How to Maximize Your Income Returns

Description

Dividend investing could become even more popular in future years. With Donald Trump's spending plans likely to push inflation higher across the globe, the era of deflationary pressure may soon be over. As such, higher-yielding stocks may become more popular. However, there is more to dividend investing than simply picking out a high yield. Here's how you can improve your returns, and lower your portfolio's risk profile.

The right type of stocks

While during prosperous years there are a number of cyclical companies paying generous dividends, in weaker years for the economy those same companies are likely to cut dividends. That's because their earnings are highly dependent on the performance of the wider economy, which means their ability to make growing shareholder payouts also relies on the macroeconomic outlook.

As such, it may be prudent for investors to instead buy stocks in more resilient and defensive industries. Healthcare, tobacco and utilities have proven popular, for example, among income investors due to their high chance of making gradually increasing dividend payments over a prolonged period. While there may be fast-growing dividends available elsewhere, in the long run the lower risk of reliable dividend-paying shares may prove to be a more useful ally for income investors.

Diversity

Another means of lowering the risk of falling dividends within an income portfolio is diversification. While healthcare, tobacco and utility stocks may be sound income plays for the long term, it can be wise to own shares in a variety of other sectors. They will not only reduce company-specific risk, but may also provide higher growth in the long run if a 'traditional' income sector undergoes a period of uncertainty or major change.

Diversifying between different geographies is also a sensible step in order to protect dividends within a portfolio. As recent years have shown, the world may be becoming more globalised, but the growth rates of economies continues to change on a regular basis. Furthermore, investing in multiple geographies can also lead to positive exchange rate translations which can boost a company's income return in the short run.

Dividend growth

Although a high yield is the most obvious means of obtaining an increased income return, in the long run dividend growth could be more important. That's especially the case since inflation has the potential to rise in the medium term, as Donald Trump's spending plans are expected to come into effect. Therefore, what may be a high real-terms yield today may not be as impressive in future years.

Since dividend growth is closely linked to profit growth and payout ratios, seeking companies with upbeat forecasts and scope to pay out a higher proportion of profit to shareholders in the form of a dividend may be a sound move. Such companies may have lower yields than many of their index peers today, but that could change over the medium term if they are able to grow shareholder payouts at a brisk pace.

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