Dividend Investors: 2 Undervalued Stocks With Yields Around 5%

Description

If you're an investor whose income depends on the dividends paid by your holdings, then you're probably on the hunt for a higher-yielding position that could give you a raise without requiring any additional capital. Higher-yielding stocks are deemed as being risky because the risk of a dividend cut is high and a sell-off is likely to follow, thus resulting in stock depreciation to go with a substantially lower dividend payout.

A dividend cut is a nightmare scenario for a retiree who relies on the income to survive. It really doesn't make a lot of sense to hang on to a stock that cut its dividend, and you'll probably be left selling the stock at a loss. Many income investors have a rule of thumb to avoid such a scenario. This isn't a principal you should copy because it isn't perfect, but it could limit your downside if things turn sour, as they usually do with artificially high-yielding stocks.

One strategy is to simply avoid all stocks with a yield above a certain value. Let's say 5% is the highest yield you'll invest in, and anything higher is likely a trap. Sure, you can avoid dividend cuts this way, but what if the markets crash and many top-tier income stocks start yielding more than 5%? Would you scratch these stocks off your watch list?

I think this rule of thumb works if you're an extremely cautious investor, but let's face it; you're not going to give yourself a raise by following such rules. I believe you can safely invest in stocks with yields 5% or even higher, but the higher the yield is, the more homework you've got to do to make sure you're not falling into a trap. Contrary to popular belief, you can give yourself a nice raise without risking your shirt; however, it's probably going to require at least little more risk. I believe a little more risk for a lot more yield is a great deal.

Let's have a look at two dividend plays with yields around the 5% mark and see if it makes sense to buy these stocks today.

Canadian Imperial Bank of Commerce (TSX:CM)(NYSE:CM)

CIBC is a solid Canadian bank that has been selling off lately. The company appears to have a large exposure to the Canadian housing market, which many pundits believe is in a bubble. I think CIBC is definitely one of the riskier plays of the Big Five banks, but the pessimism seems to be overblown, and this has caused the stock to reach an absurdly cheap valuation.

Everyone knows that the housing market is frothy, but does that mean a crash is imminent? Not exactly. A gradual cool down is probably more likely than a violent correction, and if this is the case, shares of CIBC are an absolute bargain right now.

The stock currently trades at an 8.8 price-to-earnings multiple and has a 4.81% dividend yield. I believe the stock is cheap, even when you consider the additional risks associated with an investment. The general public is overly fearful, and that's exactly when you should be a buyer.

Smart REIT (TSX:SRU.UN)

Smart REIT is one of the best retail REITs in Canada. You're probably familiar with the "death of the shopping mall" rhetoric, but I think the fears are overblown. Sure, mall traffic is probably going to decline going forward, but you've got to realize that Smart REIT's tenants are not going down without a fight.

Smart REIT's shopping centres are anchored by shops and businesses that probably aren't going anywhere over the next decade, even with the rise of e-commerce and the increasing pressures on brick-and-mortar retailers.

Movie theatres, grocery stores, and hardware stores aren't going out of business anytime soon, and these are just some of the types of stores that make up a large chunk of Smart REIT's tenant base.

Smart REIT offers investors a fat 5.52% yield which will be stable and steady for years to come.

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Author
joefrenette