Looking for Yield? Forget the Number: Buy on Safety and Growth

Description

Many yield-focused investors follow the age-old investment strategy of putting their favourite stock screener on a particular index, screening for the highest yield opportunities available in a given market, and buying what may be considered to be the best of the bunch at a 7-10% yield.

Everyone loves yield, and I can include myself in that category; however, I find that one of the beautiful (and therefore difficult) things about investing is looking for the less obvious, or more elusive, opportunities in the broader market.

When I say less obvious opportunities, I mean to say that the companies that currently exhibit excessive yields tend to also display other unfavourable characteristics. One who is interested in accepting the higher yield associated with such stocks must also be willing to accept a higher level of risk — risk that can manifest itself a number of ways (risk of lower/negative capital appreciation, risk of a dividend cut, or even risk of default). The hidden opportunities are often those that may actually provide some of the best *long-term* income opportunities, yet, at current levels do not appear to be as great as the +7% yield today.

As an example, let's take a look at **Altagas Ltd.** (TSX:ALA) with a 7.12% yield and **Apple Inc.** (NASDAQ:AAPL) with a 1.75% yield. These are two completely different companies in completely different industries; however, I want to use them to illustrate a very important point: yield is not everything.

Income-oriented investors looking only at yield for the two firms may, at first glance, be lured to Altagas by its seductive yield in excess of 7% and decide to forego Apple altogether due to the company's measly 1.75% yield.

Growth potential in terms of capital appreciation aside, Apple would seemingly not qualify in any way as an income play at first blush; however, I would venture to say that over the long term, Apple may actually turn out to be the better *income* play on the basis of compound growth, free cash flow generation, and untapped capital reserves.

Over the past five years, Apple has grown its distributions by 66%, while Altagas has grown its distributions (which some may say are unsustainable at current levels) by 52%. The 14% gap over five years between the two may seem inconsequential; however, over an investment period of decades, assuming both Apple and Altagas are able to continue raising their distributions (which I believe is unlikely due to the payout ratio of Altagas), Apple will eventually catch up to and overtake Altagas in terms of dividend yield.

Should Apple's investors demand more of the untapped capital reserves be returned to shareholders via dividends, or the company continues to churn out amazingly high rates of free cash flow growth over time compared to Altagas, a company like Apple with a relatively low dividend yield will outperform Altagas every time.

Yield is not everything.

Stay Foolish, my friends.

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