Are High-Yield Stocks Too Good to Be True?

Description

Some investors are enticed by high-yield stocks. It's not necessarily bad to invest in high-yield stocks. However, investors should be aware of the implications of doing so.

These stocks have high yields for a reason.

How's the growth of the company? Will there be a dividend cut?

Many real estate investment trusts (REITs) offer big dividends. However, some may be experiencing trouble or slow growth, including REITs with significant exposure to Alberta, such as **Boardwalk REIT** (TSX:BEI.UN) and **RioCan Real Estate Investment Trust** (TSX:REI.UN).

Boardwalk is a residential REIT focused in Alberta. It offers an above-average yield of ~5.7%, but it actually has experienced negative funds from operations per share growth since 2016.

Its payout ratio is expected to be over 100% this year, which means there could be a distribution cut. Though, in the short term, the company can still choose to maintain its distribution by other means.

Since the main driver of the Albertan economy is the energy sector, some recovery in the sector should help Boardwalk on its way to a rebound. Some pundits believe the REIT will start recovering next year.

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shopping mall

Because of RioCan's size (it's the largest retail REIT in Canada), it's harder for the REIT to grow.

Of course, there are also headwinds in the retail space. Some retailers are going out of businesses, but there are others that are thriving.

RioCan's growth will probably keep pace with inflation. In the meantime, it offers a ~5.7% yield that's covered by its funds from operations. Its payout ratio is estimated to be ~80% this year.

What's the downside risk for the stock?

Peyto Exploration & Development Corp. (TSX:PEY) is an efficient, low-cost producer of natural gas. Some investors might have thought the stock was attractive when it yielded ~5.7%, but look where it's trading now.

At ~$17.80 per share, Peyto yields ~7.4%. That represents a ~23% price decline from when the stock yielded ~5.7%. Peyto's profitability is still largely reliant on the price of natural gas.

So, what's the lesson here? Never base an investment solely on its yield. Even if a high yield is sustainable, the stock can still substantially decline.

Investor takeaway

Before buying a high-yield stock, investigate to see if its dividend is sustainable, if its growth prospects are high enough to be worth your dollars (unless you only care about the income), and if there's a big downside potential to the share price. Any negativity from any of the above three points should cause you to look for a lower entry point or to avoid the investment altogether.

CATEGORY

1. Dividend Stocks
2. Energy Stocks
3. Investing

TICKERS GLOBAL

1. TSX:BEI.UN (Boardwalk Real Estate Investment Trust)
2. TSX:PEY (Peyto Exploration & Development Corp)
3. TSX:REI.UN (RioCan Real Estate Investment Trust)

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