Will Higher Rates Be Detrimental to Dividend Investing?

Description

For many investors, the past decade has seen a huge shift to dividend investing, as the average person has finally realized that getting paid is extremely rewarding. To make matters more interesting, the understood "obligation" to pay and hopefully raise dividends paid to investors places a responsibility on company managers to deliver results and share that capital responsibly instead of frittering it away on new projects or voluptuous company events.

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Although many (including me) view the payment of a company's dividend as the absolute bottom-line truth, that we share the earnings, there remain certain companies, such as **CGI Group Inc.** (TSX:GIB.A)(NYSE:GIB), which will be less impacted by the change in interest rates. These, however, are exceptions, as most companies with track records of long-term profits actively pay dividends to shareholders.

What was previously considered an above-average yield of 5% for investors in shares of **BCE Inc.** (TSX:BCE)(NYSE:BCE) has become less attractive over the past week, as the Bank of Canada has increased rates by 25 basis points, thereby rewarding those who wish to enter risk-free investments.

Except for a marginally higher cost of borrowing for companies such as BCE, the business fundamentals remain unchanged, and yet the attractiveness of the investment has clearly declined. What was a 5% dividend yield for a given level of risk has remained a 5% dividend yield for almost the same amount of risk. The investment, however (on a comparison basis), doesn't look as good. What was previously a 1% overnight rate leading to a gap of 4% has become a 1.25% overnight rate, which now leads to a difference of 3.75%. The incremental return in excess of the risk-free rate of return is simply not as good as it was before.

When considering shares of this dividend-paying gem over the past month, the decline has been a ride down from approximately $61 per share to now less than $58 per share, which has increased the dividend yield along the way. Although the dividend has remained unchanged, the lower price has led to a higher yield in order to (at least partially) widen the gap.

In spite of many investors believing that this is an isolated situation, the truth could not be further away.

Close to a decade ago, retired investors flocked into dividend-paying stocks and proceeded to continue increasing their exposure, as long-term bonds expired and their comfort levels with securities increased. With interest rates now heading up, and investors that are a decade older, the desire to hold dividend-paying stocks may begin to shift, as interest rates reach levels worthy of consideration from investors seeking lower risk.

The good news, however, is that bonds, which have historically offered higher interest rates than the dividend yields of stocks, remain close to an all-time low. Dividend yields are still higher!

CATEGORY

1. Dividend Stocks
2. Investing

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2. NYSE:GIB (CGI Group Inc.)
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4. TSX:GIB.A (CGI)

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