Time to Sell Top Dividend Stocks As Bond Yields Climb?

Description

Rising bond yields are the biggest enemy of dividend stocks. They diminish the appeal of income-producing equities as investors find that safe alternatives, such as the government-backed bonds, are more attractive.

This phenomenon wasn't a threat during the past decade, as central bankers globally kept interest rates at historically low levels following the financial crisis of 2008. But this scenario is changing fast as central banks in Canada and the U.S. remove the monetary stimulus, encouraged by the strengthening economies.

In the latest indication that both U.S. and Canadian economies are firing on all cylinders, job data from the U.S. revealed that hiring in the world's largest economy picked up in January, with wages rising at the fastest annual pace since the end of the recession. The jobless rate held fast at 4.1%, matching the lowest rate since 2000, while average hourly earnings rose a higher-than-expected 2.9% from a year earlier, the highest increase since June 2009.

Statistics Canada reported this week that November real gross domestic product grew 0.4% month over month — the biggest one-month increase since May.

This positive news sent bond yields soaring, scaring investors away from stocks as prospects of further interest rate hikes increased substantially.

In the U.S., the yield on the benchmark 10-year treasury note reached above 2.83% for the first time since January 2014, while the Canadian 10-year government bond yielded 2.30% as Bank of Canada's experienced its third rate hike since July.

Implications for dividend stocks

This dynamic economic situation has some implications for Canada's top dividend stocks, which compete with fixed-income securities for investors who seek stable income from their assets.

If you look at the performance of power and gas utilities and telecom operators, you'll realize that they're underperforming the broader market this year amid rising bond yields.

Enbridge Inc. (TSX:ENB)(NYSE:ENB) and **BCE Inc.** (TSX:BCE)(NYSE:BCE), my two favourite picks for income-seeking investors, are both down this year. Trading at $43.72 at the time of writing, Enbridge fell ~13% this year, while BCE stock is down ~5% at $56.59.

This pullback has pushed the dividend yields of these dividend payers to extremely attractive levels. Enbridge, for example, is now yielding 5.36%, which is one of its best returns in the past decade.

The bottom line

For long-term investors, this pullback offers a great opportunity to add to their existing positions and add more of these solid dividend names to their portfolios.

There is no doubt that the threat of rising rates and inflation is real, but I don't think bonds can provide the kind of return you need to beat inflation and earn decent income. This temporary setback to dividend stocks shouldn't be taken as a long-term shift to bonds.

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