New Investors: What's So Special About Dividends?

Description

Dividend companies share profits with shareholders by paying out dividends. Dividends are real cash you can earn just by holding dividend stocks. Dividends from a portfolio of quality stocks can generate a growing income stream for you *forever*.

People who are just starting out on their investment journey might shrug dividends off right away because many are enticed by the ups and downs of stock markets and just want to make quick bucks by trading in and out of stocks. But dividends can be much more consistent, stable, and predictable than stock prices.

When share prices inevitably fall, psychologically, it's easier to hold on to dividend stocks because of the dividends that you'll continue to receive. The consistency of stable dividends in an otherwise volatile market is reassuring.

Research shows that in the long term, dividends contribute roughly a third of total returns.

How much in dividends can you get from investing $1,000?

Typically, in a normal market, you can easily find safe yields of 3-5% offered by stable businesses. The big Canadian banks are some of the most stable businesses you can buy shares of on the Toronto Stock Exchange.

Particularly, **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD) is reasonably valued at about $72.50 per share, trading at a price-to-earnings ratio of 12.8. The company will benefit from higher interest rates in the U.S. or Canada.

TD Bank offers a yield of ~3.3%. According to its usual dividend hike schedule, the bank should be increasing its dividend soon. Assuming a conservative dividend hike of ~8.3%, equating a quarterly dividend of $0.65 per share, or an annualized dividend of $2.60 per share, we're looking at a forward yield of almost 3.6%.

A $1,000 investment in TD Bank today should generate almost $36 of income for the next year. That doesn't sound like a lot.

That said, the power of dividends comes from the compound growth over many years. As well, in the first years of your investment journey, saving and investing consistently is the key.

If you had invested in TD Bank about three years ago, at which time it was also reasonably valued, you'd be sitting on unrealized gains of almost 45% (or 13.2% annualized), and your dividend would have grown nearly 28%.

If you had invested $5,500 (the contribution room for your TFSA) each year for the same kind of returns, your investment would be $20,110. And you would earn dividends of $663 this year, assuming a yield of 3.3%. (Notably, we didn't account for the dividends that would have been received in 2016 and 2017.)

Investor takeaway

New investors should consider dividend investing as a part of their investment strategy. In bad economic times, they can be reassured by stable dividends.

Save and invest consistently in good-valued, stable dividend stocks and watch your dividends grow over time!

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