Forget Interest Rates: Start Buying Solid Dividend Stocks Today

Description

Rising rates are really dropping the hammer on our poor Canadian dividend stocks. It was only a year ago that these companies were all the rage, with their 3-4% dividends being bought up like crazy by income-hungry investors. Suddenly, with interest rates on the uptick, these stocks are dropping like hot potatoes.

It's not like this was a surprise. For the better part of the last decade, talking heads on TV and article writers have been warning that this was going to come about. The drop in the share price was expected, and these stocks have now dropped to low levels if you are looking to establish a position.

There is no shortage of stocks with dividend yields higher than 5% at the moment. Many of them are established dividend payers with long histories of paying and raising their payouts. These income streams are tempting, but investors need to be aware of the fact that these stock prices are falling for a reason. That reason is that fixed-income investments are becoming a viable alternative to dividend stocks, and that alternative must be weighed against the risks of holding equities.

You have to consider how fast rates are rising. At this point, a five-year GIC is paying around 3% on an annual basis. Even if rates rise at a rate of a quarter point once a quarter, it would take two years to get the 5% that is currently easily provided by many dividend stocks, and you would have to lock your cash in at that rate for a long period of time.

The main reason an investor would choose fixed income as opposed to dividend stock would be to preserve capital. If rates continue to rise, there is a very real possibility that investors in dividend-paying stocks would continue to lose some capital in the short to medium term. When those stock prices keep going down, as I have seen with my **BCE** (TSX:BCE)(NYSE:BCE) shares recently, it becomes pretty hard to sit there and watch.

So, watch the yield instead of the price! It is easy to forget one easy fact when your capital is temporarily wasting away: when the stock price goes down, the yield goes up! That's right, your 5.5%-yielding stock is now sporting a 6% yield! It would now take three years of quarterly, 25-basis-point interest hikes to make up the difference. Besides, when our stocks are going down the tubes, it is easy to forget that in the long run these stocks can also go up. There is much less chance of capital gains from your GICs, I'm afraid.

Apart from the increased yield, don't forget that many of these stocks hike their dividends each and every year. Companies like **Pembina Pipeline** (TSX:PPL)(NYSE:PBA) and BCE have hiked their dividends every year, and those dividends are backed by steady, solid cash flows. Pembina has long-term contracts as well as improving industry fundamentals supporting its payout. While it does not have locked in contracts, BCE's leading wireless position also should continue to generate free cash flow growth, allowing it to continue to grow dividends in the future.

The last nugget people seem to miss is the fact that Canadian dividends have a more favourable tax status in Canada than interest income. This beneficial tax treatment gives investors an extra income boost that the fixed-income interest crowd just doesn't have.

Even though I'm coming down a little heavy on the GICs and fixed income, I know that it has its place. Sometimes, though, it can be hard to buy stocks when they are falling, but that is precisely when you need to get in. A few years ago, everyone was crowding into these dividend payers when the yields were small. These same companies, which have experienced very little fundamental change, are now being tossed aside.

Get in now and collect rich income. Of course, these companies' share prices probably will continue to fall in the near term, so get in gradually. But even if you buy now and hold for the long term, getting a growing, higher-than-5% dividend should beat the GIC and bond prices any day.

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