3 Keys to Successful Dividend Investing

Description

Dividend stocks are perennial favourites of long-term investors. Offering safety, stability, and better income than most bonds, they're the cornerstone of any long-term portfolio. But not all dividend stocks are created equal. For every high-yield stock you can count on for consistent income, there's another unsustainable dud with a payout ratio that can't last. Knowing the difference is the key to successful dividend investing.

In this article, I'll review the three keys to investing in dividend stocks. These are not the be all and end all of income investing, but they're a great starting place for investors who are just getting their feet wet. I'll start with the most obvious (but often misunderstood) point about dividend investing.

1: A high (but sustainable) yield

Every dividend investor wants a high yield. Today, that generally means anything north of 3%. But it's easy to shoot yourself in the foot by investing in a stock with an overly high yield that's not sustainable. The key here is to look at the stock's payout ratio — that is, the percentage of earnings that are paid as dividends. If a company is paying out more than 80% of its earnings as dividends, then there's a good chance you'll find that dividend cut in the near future, unless earnings growth is phenomenal. For this reason, it's good to take a skeptical look at stocks that yield north of 5% — they're often "too good to be true."

2: Dividend growth

Let's say you find a stock that yields 2%. "Meh," you say, "I can find better." But look closer. What's the stock's dividend history? If the company has been raising the dividend by 10% every year, that 2% could grow to 4% before you know it.

One great stock for dividend growth is **Fortis** (TSX:FTS)(NYSE:FTS), which has an uninterrupted 44-year history of raising its dividend. A Fortis share purchased 10 years ago would have yielded about 3.5% at the time, but that yield would be about 7% by today. One thing to be aware of about Fortis, however, is that the company has been experiencing some earnings issues that may disrupt its ability to continue the dividend-raising streak.

3: Solid financials

Last but not least, any dividend stock needs solid financials to keep the payouts coming. Here you want to look for high profit margins, high ROE, low dividend payout ratios and high earnings growth. One stock that has all of these in spades is **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD). TD's dividend yield is not the highest of any Canadian bank stock, but it more than makes up for it with fantastic profitability and growth that you can count on to keep those dividends rising into the future. Once again, it's not the yield today that matters so much as where the yield will be in the future.

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