Why I'm Betting On Dividend Stocks To Boost Retirement Income

Description

With the world economy having experienced a decade of loose monetary policy, it appears as though changes could be ahead. Clearly, an ultra-low interest rate will not last in perpetuity, so it is a matter of when, not if, an increasingly hawkish monetary policy will come into effect.

A rising interest rate may, of course, have a negative impact on the stock market. In particular, it could hurt the appeal of dividend stocks. While this may be a concern, income-producing companies could still offer an impressive return for individuals seeking to boost their retirement income.

Increasing interest rates

Higher global interest rates could have a negative impact on the performance of the world economy. The US interest rate, for example, is expected to rise during the course of 2019. This could cause challenges for countries which have dollar-denominated debt, since the interest they are paying may increase. They may also be impacted by a stronger dollar, since a higher interest rate can cause a currency to strengthen. This may make it more costly for them to repay debt, and could hold back their economic performance.

A rising global interest rate may also hurt the performance of the stock market. As well as potentially lower earnings growth from a slowing world economy, other assets such as cash and bonds could become increasingly attractive relative to stocks. This is especially relevant for dividend stocks, since the difference in income return that they offer versus lower-risk assets may be reduced. This could mean that investors do not feel they are worthy of their current risk premium, which may cause deteriorating performance over a sustained time period.

Income appeal

However, in many cases dividend stocks have low valuations at the present time. Their high yields suggest that investors have, in many cases, factored in the potential risks posed by rising interest rates. This could mean that they are more resilient, and offer more favourable risk/reward opportunities, compared to cash and bonds.

Furthermore, the pace of interest rate rises is set to be relatively slow. The US, for example, is being very wary about how quickly it tightens monetary policy, since there is a danger that it chokes off its own economic performance. As such, dividend stocks could continue to offer income appeal – especially with global risks such as a slowing China and increasing protectionism causing valuations to be somewhat lower than they may otherwise have been.

Volatility

While dividend stocks could experience a period of heightened volatility as interest rates rise, for a retiree who is focused on income this is unlikely to be a cause for concern. By investing in a variety of companies that have strong balance sheets and resilient cash flow, it may be possible to generate an impressive level of income return over a sustained period of time. Even if valuations disappoint in the short term, they are likely to recover in the long run.

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