Why A Passive Income Is Not Just For Retirees

Description

While generating a passive income from an investment portfolio is a necessity in retirement, it can provide numerous benefits at any stage in life. For example, it could offer the chance to reinvest in stocks at more opportune moments such as during bear markets. Or, it could help to pay the cost of a home, or other regular outgoings.

As such, it could be worth concentrating on dividend stocks to a greater extent. Through focusing on yields, dividend growth prospects and the financial strength of a company, it may be possible to generate a surprisingly high passive income over the long run.

Passive income benefits

As mentioned, a passive income could prove to be a useful ally for investors of any age. In fact, it could become increasingly appealing over the coming years. The world economy has enjoyed uninterrupted growth since the financial crisis, but this now may be set to come to an end.

A combination of factors that includes rising US interest rates, a slowing Chinese economy and weaker economic data emerging from both countries could lead to a fall in stock prices over the medium term. An investor who is generating a passive income from dividend stocks may be able to capitalise on this through having the required cash flow to invest in high-quality stocks that trade on low valuations.

Furthermore, a passive income could boost an individual's overall financial situation. With house prices having risen significantly in recent years, the cost of owning a property has risen at the same time as interest rates have remained subdued. As such, it may be possible to obtain a higher income return in the stock market than is being paid on existing long-term debt. Over a period of many years, investing in dividend stocks could therefore prove to be a more worthwhile idea than paying back long-term debt which is being borrowed at a relatively low rate.

Buying dividend stocks

While a high dividend yield is clearly appealing when it comes to generating a passive income, so too is the rate of dividend growth. This can impact on a stock's valuation in the eyes of investors, and may lead to improving capital returns over the long run. As such, investors may wish to consider a company's track record of dividend growth, as well as its forecast growth rate.

Alongside this, the affordability of dividends is a key part of income investing. A company that has a low dividend coverage ratio (calculated by dividing net profit by dividends paid per year) may be unable to raise dividends at a fast pace. It may also signify that the company in question could be forced to cut dividends in future, should its financial performance come under pressure.

Of course, checking a company's balance sheet and economic moat is crucial before buying it. Doing so could reduce the risk of disruption to dividend payments over the long run, and may mean that an investor is better able to benefit from the improved cash flow offered by income stocks.

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