



Dividend Stocks: Why a High Yield May Not be The Best Way to Make a Million

Description

While a high dividend yield may be appealing when it comes to investing in dividend stocks, focusing on it in isolation may not be the most effective means of increasing your overall returns.

Certainly, a high income return today can lead to improving financial returns in the long run. But other aspects of dividend stocks, such as their financial strength and the potential for dividend growth, may be equally important.

Therefore, it may be prudent for income investors to take a holistic view of their investments, rather than just focusing on a high yield.

Financial strength

One key area to focus on when buying dividend stocks is their financial strength. Doing so could increase the chances of an investor's income being sustainable over the long run.

Therefore, it may be worth checking a company's balance sheet, with lower debt and higher interest cover suggesting that they may be in a relatively strong financial position. It may also be worthwhile focusing on the track record of the company when it comes to making dividend payments. Should they have been able to pay a rising dividend during more challenging economic periods, it may indicate that they have a strong platform for future dividend growth.

Of course, some stocks are more cyclical than others. For investors who desire a strong and robust income over the long run, it may be prudent to concentrate their capital on mature companies that operate in defensive sectors. Otherwise, should there be an economic downturn, they may see their income levels decline to some degree.

Dividend growth prospects

As well as checking the sustainability of a dividend, it is a good idea to determine the growth potential

of a company's payout. A high rate of dividend growth could turn a modest income into an appealing level within a matter of a few years.

A company that has a low dividend payout ratio, which is calculated by dividing dividends paid by net profit, could indicate that there is scope for it to raise dividends. Likewise, a business which has a sound strategy and that is forecast to deliver strong earnings growth may be able to increase shareholder payouts in the medium term.

A high rate of dividend growth may suggest to investors that the company is experiencing an improved financial period, and that its management team is confident in its prospects. This may increase demand for the stock, and lead to a higher valuation. In turn, this may boost an investor's capital gains over the long run.

Takeaway

Focusing on a dividend yield in isolation may not be the best way to make a million from [dividend stocks](#). Instead, considering their dividend growth potential and dividend affordability may allow an investor to find the best income stocks that are able to have the biggest impact on their financial future.

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