Retirement Saving: 3 Things I Wish I'd Known About Dividend Investing

Description

Dividend investing can produce high total returns in the long run. However, deciding which factors to focus on in determining the stocks that are held within a portfolio can be challenging.

Looking back on my own dividend investing performance, I wish I had appreciated the importance of factors such as dividend affordability, the impact that dividend growth can make on a stock's price, as well as the difference that dividend reinvestment can make on a portfolio.

Here's why those three factors could have a bigger impact on the potential to generate a long-term passive income than many investors realise.

Dividend affordability

The appeal of a high yield can be overwhelming for many income investors. However, there is much more to being a successful income investor beyond buying the stocks with the highest yields.

Assessing a company's dividend affordability should perhaps be the first port of call for income-seeking investors. After all, a high yield is of little use if it cannot be paid over the long run.

Through focusing on figures such as dividend cover or a company's payout ratio, it may be possible to determine how much headroom it has when making payouts to its shareholders. Although doing so may not guarantee dividend sustainability, it could reduce the risk of slow growth, or even a dividend cut.

Dividend growth potential

Allied to the idea of assessing the affordability of dividends is how quickly they could grow. For example, a 5% yield may be appealing today. However, if there is a lack of dividend growth, a long-term investor may be better off buying a stock with a 4% dividend yield that can record a rising dividend over the coming years.

Not only could this lead to an improving income outlook over the long term, the company that offers stronger dividend growth may also deliver capital growth. A rapidly-rising dividend can catalyse investor sentiment and produce higher total returns than a stock which is unable to raise shareholder payouts.

Compounding

While almost all investors understand the concept of compounding, it is perhaps only after investing for a number of years that its true potential becomes evident. Even investing modest sums, or reinvesting a limited amount of dividends received, can lead to significant growth in the value of a portfolio over the long run.

Therefore, avoiding withdrawals from a portfolio wherever possible could be a good idea. This is especially the case during bear markets, where reinvesting dividends can have its greatest impact due to the wide availability of stocks with margins of safety during such periods.

Although compounding may take a number of years to be felt, it can have a major impact on an investor's financial situation. As such, living within your means and reinvesting dividends wherever possible could be a worthwhile move over the long run.

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Author
peterstephens