How to Generate a Passive Income Each Year From Dividend Stocks

Description

Investing in dividend stocks could prove to be a sound means of generating a passive income in the long run. However, selecting which stocks to include in a dividend-focused portfolio may seem to be a challenging task for some investors.

With there being a wide range of options, it could pay to become increasingly selective and look beyond a company's dividend yield in order to find the best opportunities. Doing so could lead to a higher, and more sustainable, passive income in the long run.

Track record

While the past is not a perfect guide to the future, companies that have been able to deliver improving profitability over a long time period may have wide economic moats. For example, they may have lower costs, a stronger brand or greater differentiation versus peers that has enabled them to post impressive financial gains over previous years.

This can suggest that their future dividend growth will be resilient and robust. That's especially the case if they have a history of rewarding shareholders through paying out a dividend that rises in line with profitability.

Management focus

Through analysing company annual reports, it is possible to ascertain management standpoints on future dividend growth. For example, some management teams will focus on the reinvestment of excess capital in order to enhance the future sales and profitability of the business. While this can be a sound move in some circumstances, for investors who are seeking a passive income in the medium term it may not offer the most appealing outlook.

Similarly, company management may adopt a higher-risk approach that seeks to expand the business into new markets or territories at a fast pace. This could mean that reduced dividend growth may be ahead. As such, it could be a good idea to ensure that the aims of company management from a risk/reward perspective are aligned with those of the investor.

Company type

While industries such as technology may offer strong earnings growth potential, they are unlikely to offer generous dividend growth due to the reinvestment of large amounts of capital. Likewise, less mature businesses may require greater reinvestment, and may be unable to pay out dividends to shareholders.

As such, it could be a good idea for an investor to assess the maturity of a business, as well as the stability of the sector in which it operates, prior to purchase. For investors who are seeking little more than a passive income, mature stocks operating in more defensive industries could be a good place to start when selecting the best income opportunities for a portfolio.

Takeaway

Assessing a company's track record of growth and dividend payments, as well as its strategy, could lead to higher and more stable growth in an investor's passive income. Likewise, assessing a company's maturity, as well as the industry in which it operates, may lead to a more resilient income outlook. As ever, diversifying among a range of stocks can help to reduce risk, while opting for the stocks that fit with an investor's risk/reward goals could lead to a better shareholder experience.

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