



How to Generate \$5,000 in Passive Monthly Income

Description

Everyone *wants* a passive monthly income stream, but few *have* one. That's because it takes a lot of work, and most important, seed capital. But if you save diligently and invest in the right stocks, it's not too difficult to generate passive income of \$5,000 or more each and every month.

How is this possible? Most income-based investors use dividend stocks to generate income. While that's a fine idea, it's not necessarily your fastest way to achieving passive earnings. In fact, Warren Buffett has warned investors *against* buying dividend stocks purely for their income potential.

The Warren Buffett strategy

In his 2012 shareholder letter, Buffett outlined the four ways a company can spend its cash. It can:

1. Reinvest to fund future growth
2. Make acquisitions
3. Buy back stock
4. Pay a dividend

Berkshire Hathaway Inc. (NYSE:BRK-A)(NYSE:BRK-B), Buffett's holding company, only engages in the first three options. In its entire operating history, Berkshire Hathaway has never paid a dividend.

Why not?

"A number of Berkshire shareholders—including some of my good friends—would like Berkshire to pay a cash dividend," Buffett wrote in 2012. "It puzzles them that we relish the dividends we receive from most of the stocks that Berkshire owns, but pay out nothing ourselves."

Buffett prefers to keep the cash because he's proven capable of growing that cash at 10-20% annually for decades at a time. That's significantly better than what Berkshire investors could achieve elsewhere.

If the company were to pay a dividend, investors would likely put the capital in a vehicle with *lower*

growth potential. That doesn't sound like a great deal. By keeping the cash inside of Berkshire Hathaway, Buffett can invest it perpetually at market-beating rates.

But if there's no dividend, how do you generate a monthly income stream? The answer is simple: sell stock piece-by-piece. This is exactly the method Buffett suggests for Berkshire Hathaway shareholders.

Here's what to do

You can always buy Berkshire Hathaway stock directly to tap into Buffett's income-producing strategy, but with a market capitalization of \$500 billion, the company's biggest growth days are over. Instead, focus on great capital allocators that can compound capital for decades to come.

Two ideal stocks are **Canada Goose Holdings Inc** ([TSX:GOOS](#))([NYSE:GOOS](#)) and **Fairfax Financial Holdings Ltd** ([TSX:FFH](#)).

Canada Goose is worth just \$6 billion and is growing sales and profits by 20-30% annually. Trading at just 30 times forward earnings at writing, I believe shares could [double in value](#) over the next few years. It likely has at least a decade left of industry-leading growth.

Fairfax Financial runs the [same strategy](#) as Berkshire Hathaway, with a similar multi-decade track record. Yet the current valuation is just \$18 billion, meaning that it could double or triple in size with ease.

If you want to generate \$5,000 in monthly income, you'll need a decent-sized nest egg. Thankfully, the same two stocks listed above can help you generate a nice pile of cash—just note that it will take some patience. If you can muster \$10,000 in savings per year split evenly between Fairfax Financial and Canada Goose stock, you could be sitting on \$665,000 within 15 years.

Assuming that those two stocks can still grow at 9% annually or more (Fairfax Financial has averaged 17% annual returns since 1985), you'll be able to sell \$5,000 in stock per month *forever*, although you'll likely want to diversify further at that stage of your life.

This is an incredibly simple strategy and one that Warren Buffett endorses. The trick is to begin saving *today* and to remain patient.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. NYSE:BRK.B (Berkshire Hathaway Inc.)
2. NYSE:BRKA (Berkshire Hathaway Inc.)
3. NYSE:GOOS (Canada Goose)
4. TSX:FFH (Fairfax Financial Holdings Limited)
5. TSX:GOOS (Canada Goose)

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