TFSA Investors: Should You Invest in “Hot IPOs” or Stick to Dividend Stocks?

Description

In today’s market, investors have many options to choose from. Between growth stocks, dividend stocks, and managed products, it can be hard to decide what to buy. Of course, you always have the option of buying a little of everything. But the more you diversify, the lower your chances of beating the market. The safest equity investments on earth are index ETFs, which spare you much volatility but guarantee that your returns will only be average.

If you’re looking to do a little better than the market, you need to concentrate your holdings to some extent. Although almost all investors diversify, many successful investors, like Warren Buffett and Phil Fischer, recommend only owning a few stocks. Owning, say, three or four stocks gives you a measure of diversification, while not killing your chances of doing better than average.

If this is the kind of approach you want to take, then you need to decide which types of stocks you’ll be investing in. Will you buy recent IPOs and try to get rich? Or will you stick to blue-chip dividend payers and play it safe? It’s a decision that every stock picker has to make (barring those who opt for a bit of both). The following are three considerations to help you make your choice.

Potential returns

Emerging growth stocks, including recent IPOs, have higher potential returns than blue-chip dividend stocks do. The bigger something gets, the less able it is to keep up past growth, so naturally, the smaller stocks have further to go — *if everything goes right*. If you look at the recent TSX IPO **LightSpeed POS**, for example, you’ll notice that it quickly rose over 90% from its IPO price in just a few months. That’s a stellar return that even the best blue chips rarely match, and Lightspeed is only a bit player in the grand scheme of things.

However, for all the *potential* upside IPOs have, they can also do quite poorly. **Lyft**, for example, tanked after its IPO, despite the broader markets doing quite well at the same time. A higher potential ceiling doesn’t mean higher returns. With that established, we can move on to dividend stocks.

Income generation

Dividend stocks are typically, but not always, blue chips that are less volatile than their growth-oriented peers. Most of them have steady and dependable earnings histories, which allows them to pay a portion out to investors.

Consider a stock like **Enbridge** (TSX:ENB)(NYSE:ENB) for example. Enbridge has paid a dividend every single quarter for the past five quarters and increased its payout from $0.67 to $0.73 in Q1. It's all thanks to the company's steady revenue and growing earnings, which increased from $250 million four years ago to $2.8 billion last year. Although Enbridge's stock price gains haven't been amazing, the income paid from the shares has been solid. And with the company raising its dividends by about 13% a year, investors have seen their payouts increase over time.

Foolish takeaway

Ultimately, the decision to invest in growth stocks or dividend stocks comes down to risk tolerance. Growth stars and IPOs have more potential upside, while dividend stocks are a more certain thing. All investors could use a little of both in their portfolio. Just remember that high risk doesn't guarantee high returns.

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