TFSA Investors: Don’t Miss Out on Hidden Dividends Worth Nearly $50 Billion

Description

Dividend stocks are the bedrock of any passive-income portfolio. However, savvy investors recognize that dividends are not the only way a company can compensate its shareholders. Share buybacks are a subtle method for creating shareholder value without cash handouts and the tax implications involved with dividends.

Stock buybacks or repurchases can reduce the number of shares outstanding, effectively increasing the earnings per share and driving the value of each share higher over a short period of time. This creates a covert monetary reward for shareholders, which is why I think of buybacks as “hidden dividends.”

In recent years, buyback programs have seen a resurgence across North America. According to *The Globe and Mail,* Canadian stocks have deployed over $50 billion in buybacks over the 12 months that ended in March 2019. That’s the highest rate of share repurchases since before the financial crisis.

Arguably, undervalued companies like **CGI** and **Great-West Lifeco** are leading the charge here. CGI managed to reduce its outstanding share count by 4% between September 2018 and June 2019. In April 2019, Great-West Lifeco announced its intention to repurchase shares worth $2 billion, which represented 6.5% of the company’s market value at the time. In fact, Great-West’s parent company, **Power Corporation**, intends to deploy a total of $5 billion in repurchases in the near term through its various subsidiaries.

Both CGI and Power Corp stocks are up 21% and 13.5%, respectively, year to date. There’s no doubt that their generous buyback programs contributed to at least some of that gain.

However, investors don’t have to pick individual stocks to benefit from the price appreciation kicked off by buybacks. **First Asset U.S. Buyback Index ETF** and **First Asset Canadian Buyback Index ETF** are both exchange-traded funds that hold a basket of stocks based on their buyback rate.

Over the past two years, the U.S. buyback ETF has outperformed its benchmark index by 282 basis points, while the Canadian one has outperformed its benchmark by 192 basis points over the same period. In other words, both ETFs have managed to successfully capture the value-creating impact of share buybacks.

Taking stock buybacks into consideration while implementing an investment strategy seems like a good idea, but investors should be aware of a few caveats.

Firstly, these stocks may not be well suited for investors who rely on the dividend yield of their Tax-Free Savings Accounts to supplement their income or fund their retirement expenses. Buybacks offer capital appreciation over immediate income, which can reduce the effective yield on a dividend-oriented portfolio.

Secondly, buybacks are not always successful and their impact is difficult to assess. A company can overpay for its own shares and end up destroying value for shareholders over the long term. It can also fail to live up to its own promise of executing a buyback fully. These factors make buybacks less reliable than clear-cut dividend payouts.

Stock-repurchase programs may not be perfect, but they certainly deserve a spot on every investor's toolbox as useful indicators of intrinsic value.

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