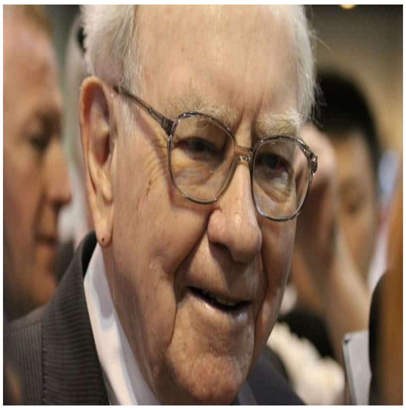

How Warren Buffett’s Tips Can Help You Generate a Growing Passive-Income Stream

Description

Warren Buffett may not be primarily viewed as an income investor, since his focus has historically been on generating capital growth from his portfolio. However, the world’s most successful investor could offer sound advice when it comes to building a portfolio of stocks that is able to provide a growing passive-income stream over the long run.

In fact, by focusing on value opportunities, assessing the quality of the companies being purchased and adopting a long-term time horizon it may be possible to enhance your income returns.

Value opportunities

While buying relatively cheap stocks could provide heightened levels of capital growth, it may also reduce the risks inherent in investing in a company. In other words, buying a stock while it is fairly priced, or even cheap, may lead to reduced risk of capital loss due to it having a margin of safety included in its market valuation.

Although capital returns may seem unimportant to income investors, stock price changes can have an impact on an investor’s psychology. For example, paper losses during a bear market may cause an investor to focus their capital on other mainstream assets, such as bonds, in order to limit their risk of further loss.

Through buying cheaper stocks, it may be possible to enjoy an improved shareholder experience. You may become less concerned about portfolio movements as a result of the increased likelihood of generating capital growth from undervalued stocks in the long run.

Quality businesses

Being a value investor such as Warren Buffett entails much more than simply buying cheap stocks. Buffett, for example, focuses heavily on the quality of the companies which he owns in his portfolio. In fact, he has often stated that he would ‘rather buy a great business at a fair price than a fair business at a great price’.

For income investors, the quality of a business may be most relevant when it comes to the sustainability and growth potential of its dividend. If, for example, a company has a sound long-term growth outlook and its dividend is affordable given the current level of profitability, it may be a relatively high quality dividend stock.

Likewise, a track record of dividend growth, as well as a management team that has a history of delivering improving financial performance, may increase the chances of a business producing rising dividends for its investors.

Holding period

While dividend investors are likely to have a long-term time horizon, Buffett’s favourite holding period is apparently ‘forever’. As such, many investors who consider themselves to be long-term focused may wish to extend their holding periods yet further.

Not only could this provide the opportunity for reinvested dividends to have a positive impact on the valuation of your portfolio, it may also mean that a company has a greater amount of time through which to deliver improving profitability as a result of a new strategy. By allowing a company the time to produce rising profits and cash flow, you could enjoy rapidly-rising growth in your passive income.

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