



3 Simple Steps to Buy the Best Dividend Stocks and Make a Million

Description

It can be tough to find the best dividend stocks. With interest rates having been low for a number of years, investor demand for income stocks has increased. In some cases, this may mean that yields have been compressed and the income returns available are somewhat limited.

However, there continue to be a number of [appealing dividend stocks](#) available that could enhance your chances of making a million. Here are three simple steps which could help you to find them. By following them you could enjoy relatively high returns and an improving financial outlook.

Affordability

Perhaps the most important consideration for any income-seeking investor is the affordability of a company's shareholder payouts. Indeed, there is little to be gained for an investor in buying a stock that is unlikely to be able to afford its dividend over the long run.

Assessing a company's dividend affordability can be relatively straightforward. Comparing previous and forecast dividend payments to net profit and free cash flow provides an indication of the headroom that is available when shareholder payouts are made. A lack of headroom suggests that even a modest fall in earnings or cash flow, perhaps during a recession for example, could lead to difficulties in paying dividends.

Return potential

Clearly, obtaining stocks with high dividend yields is likely to be appealing for any income investor. However, dividend stocks can produce impressive levels of capital growth over the long run which may even surpass their income returns.

As such, focusing on stocks that offer good value for money in terms of valuation metrics such as their price-to-earnings (P/E) ratio or price-to-book (P/B) ratio could be a shrewd move. They may offer wider margins of safety than their index peers, which could reduce risk and increase the potential for rewards

over the long run.

While cheap stocks may prove to be value traps, in many cases unpopular stocks can offer high total returns in the long run. Being prepared to go against the wider investor consensus and buy undervalued dividend stocks could be a highly profitable move.

Dividend growth

Although a high yield may be attractive in the short run, dividend growth could become increasingly important over a period of many years. Rapid dividend growth not only increases an investor's returns from an income perspective, it could boost demand for the stock in question among other investors. In turn, this may lead to a higher rating and rising stock price.

By focusing on a company's strategy and dividend policy, it may be possible to gain an insight into its future dividend prospects. Through buying those companies that have a generous policy in terms of paying a high proportion of future profit growth as a dividend, it may be possible to obtain fast-paced growth in your income returns which ultimately increases your chances of making a million.

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