3 Steps to a $1,000-a-Month Passive-Income Portfolio

Description

Can you generate $1,000 a month with absolutely no work? It seems for most Canadian families, the answer should be yes, but it isn't. Here's a closer look at why you could (and probably don't) have a passive-income portfolio, and what you can do about it.

A closer look at Canadian wealth

The Survey of Financial Security, published by Statistics Canada in 2017, found that the median wealth per Canadian household was $295,100. Considering it's been two years since that report, it might be fair to round that figure up to $300,000 by now.

Applying the 4% rule to that amount yields $12,000 in passive income per year, or precisely $1,000 per month. In other words, more than half of all Canadian families should be able to easily generate substantial passive income per month.

However, the bulk of that wealth is locked away in the primary residence, which is why most Canadians are nowhere close to financial freedom. Nevertheless, for the richest families, dedicating $300,000 to a passive-income portfolio isn't far-fetched.

Here's my top-down, three-step strategy for creating this portfolio.

Start with the highest yield

Generating a sufficient yield is the first step towards creating a passive-income portfolio. If the dividend yield on your investments is abysmal, say 1%, even a million-dollar portfolio won't be enough to sustain your living expenses.

As a general rule, I like to set the minimum required yield at 4% or above. That baseline instantly rules out most bonds and high-interest savings accounts. When you account for expenses, even the average rental property won't meet that criteria. Also, given the highly leveraged state of Canadian real estate, I'm wary of real estate investment trusts (REITs).

That leaves dividend stocks as the best option. **iShares Canadian Select Dividend Index ETF** (TSX:XDV) is a great place to start. This exchange-traded fund (ETF) offers a portfolio of 30 of the highest-yielding Canadian companies. At the moment, the ETF offers a dividend yield of 4.5%, paid out on a monthly basis.

Diversify industries

I find that the Dividend Select ETF is overexposed to one industry — finance. 60% of the ETF's assets are invested in financial companies and seven of the top 10 holdings are all banks.

Although Canada's banking sector is a robust source of stable income, I believe overexposure to *any* sector is a risk for a long-term investor. So, I prefer narrowing down the top four sectors in the XDV portfolio for better diversification. Right now, those top sectors include finance, communications, utilities, and energy stocks.

Check cash sustainability and industry outlook

The final step of the process is to analyze the financial strength of individual companies on the XDV portfolio. Both **BCE** and **Telus** are on the XDV portfolio, for example, but the former offers a higher yield with a lower debt-to-equity ratio, which makes it an arguably better bet.

Bottom line

Passive-income portfolios need to strike the perfect balance between yield and long-term sustainability. By starting with the highest-yield stocks and narrowing down the focus to the companies with the most robust finances spread across different industries, most savers can easily create a $1,000-a-month dividend income portfolio.

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