



3 Simple Steps I'd Take to Generate a Passive Income With Dividend Stocks

Description

With interest rates being at relatively low levels, it may be more challenging than ever to generate a passive income. In fact, savings accounts and bonds may, in many cases, fail to deliver a return that is significantly higher than inflation.

As such, investing in the stock market could prove to be a sound move. There are a number of stocks that could deliver an impressive income return in the long run.

By focusing on the affordability of their dividends, their growth prospects and ensuring you buy a diverse range of businesses, generating a passive income with dividend stocks could be a highly achievable goal.

Dividend affordability

Although a company's dividend yield may naturally be viewed by many investors as the most important determining factor in deciding whether it is worth purchasing, the affordability of its shareholder payouts could be even more critical. A high yield today is unlikely to be especially attractive to most people if it becomes unaffordable over the coming years.

As such, determining whether a company can afford its current level of dividend could be highly important for all investors. This can be evaluated by focusing on a company's payout ratio, which is calculated by dividing its dividends by its net profit, or by comparing its free cash flow to its dividend payments. This provides guidance on the headroom available to the business when making payments to shareholders, and could indicate whether they are affordable.

Dividend growth

While a [high yield](#) may be attractive, the pace at which a business is able to raise its dividend payments could be equally appealing over the long run. Not only could a fast-rising dividend lead to a higher passive income for long-term investors, it may also cause investor sentiment to improve.

Investors may be attracted to a company that raises dividends quickly due to its improving overall financial performance, which could lead to a rising stock price.

Assessing whether a company has strong dividend growth potential can be subjective. However, by focusing on the growth strategy being employed by the business and its track record of dividend growth, it may be possible to ascertain the likelihood of rising dividends over the long term.

Diversity

Perhaps one of the most important parts of generating a passive income through dividend stocks is to spread the risk across a wide number of companies. Even the best investors occasionally make mistakes, in terms of buying stocks that go on to experience financial challenges. As such, ensuring that declining stocks do not impact significantly on your wider portfolio performance, and your passive income, is crucial.

With sharedealing costs having fallen in recent years as online sharedealing has become increasingly popular, it has never been easier to build a diverse portfolio. As such, with global economic growth being uncertain at the present time, now could be the right time to ensure that your portfolio contains a range of varied businesses.

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