Retirees: Income Now Comes at Great Risk

Description

Pretty much exactly one year ago, I was pounding the table to buy dividend stocks. Utilities like **Emera** (TSX:EMA) were yielding over 6% and were trading at low valuations. Everyone was throwing out the baby with the bathwater, and it seemed that all you had to do was put cash into telecoms, utilities, and pipelines, and you could get some excellent returns from the yields alone.

What a difference a year makes. The bathwater has sloshed from one side of the tub to the other. These previously cheap stocks, with the exception of the pipelines, are now trading at huge valuations resembling growth stocks. Everyone has jumped back into these yield plays as rates have started coming down again.

This makes an easy choice a hard one, as people are once again trying to determine whether they should buy these steady dividend payers at higher valuations to lock in some income generation.

The easy answer is that these stocks, if you already own them, are now a hold. I would not generally condone rushing out to sell stocks simply because they appear expensive. Who knows? After all, how long it will be until rates begin to rise once again? If you purchased these stocks a long time ago, or at least last year, you will have a reasonable yield on a relatively low-cost basis.

But I certainly would not say it is a good move to buy these stocks today. Stocks like Emera are up over 30% in the last year, moving up parabolically, as investors search for steady yield. It can be tempting to get in. Emera's dividend sits at over 4% at the current share price, compared to the approximately 2% you can get on an average five-year GIC.

Furthermore, there is dividend growth in Emera that has an inflation-beating appeal. Recently, the company increased the annual payout from $2.35 a share to $2.45. The company also affirmed its position of increasing dividends by 4-5% each year until at least 2022.

This is positive, there is no doubt, but there is also increased risk that the stock could pull back significantly should market sentiment change. This is a slow-growth stock that is priced like a growth stock due to demand for yield.

Utility stocks are riskier today

I am not worried about companies like Emera and their ability to pay dividends. The relatively high yield and dividend-growth prospects are very tempting if you hunger for income. But it is important to keep in mind absolute returns when you are investing. If you do not have any position in Emera, it might be worth putting some money in for the yield. And if you already own it, I would not sell.

But do not for a moment think that these stocks are riskless. They are priced to perfection, and you may very likely see a sharp pullback in share prices if the hunger for yield ends for one reason or another. That is precisely what happened last year when these stocks were raging buys. Be careful and exercise caution when buying utilities today.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. TSX:EMA (Emera Incorporated)

PARTNER-FEEDS

1. Business Insider
2. Msn
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