How I'd Make a Passive Income With Dividend Growth Stocks

Description

Focusing solely on a company's dividend yield when seeking to make a passive income may not be an optimum strategy in the long run. After all, a high yield today may fail to remain attractive if dividend growth does not beat inflation.

As such, focusing on a company's dividend growth potential could be highly important for income investors. By considering the affordability of a company's dividend, its overall financial outlook and diversifying across a range of businesses, it may be possible to enhance your long-term passive income.

Dividend growth opportunities

While high-yielding stocks could offer income returns that significantly beat other mainstream assets such as cash and bonds in the short run, a key goal for many income investors is to beat inflation. In other words, they want their passive income to rise at a faster pace than inflation every year. This enables them to have increasing spending power, and greater financial freedom.

Therefore, companies that can offer dividend growth over the long run could be of great appeal to income-seeking investors. In some cases, they may offer high yields today. But in others, investors may have to compromise on a lower present-day yield versus other income stocks in return for an improving dividend outlook in the long run. For many long-term investors, a faster pace of dividend growth may be more attractive because it could ultimately lead to a higher amount of income during their investment horizon.

Assessing dividend growth

Cleary, no company can guarantee dividend growth. But an investor can increase their chances of accessing it by focusing on company fundamentals. For example, an investor may wish to consider the affordability of a company's dividend by assessing its dividend cover. A large amount of headroom may mean there is scope for its divided payments to rise at a faster pace than its earnings.

Similarly, considering a company's net profit growth potential may provide an insight into its dividend prospects. A business that is expected to produce a rapid rate of profit growth could use a portion of it to reward investors. In addition, a company that has a solid track record of rewarding investors, or that is mature and does not need to reinvest large sums of profit, could provide impressive levels of dividend growth in future.

Risk reduction

As with any other investment, buying a diverse range of dividend growth shares could reduce overall risk within a portfolio. This may mean that your dividend growth prospects are more reliable, as well as being more likely to beat inflation.

Although it may seem as though dividend growth stocks are riskier than high-yielding shares with more limited dividend growth potential, for long-term investors the risk of losing spending power may mean they are essential.

Through focusing on company fundamentals and diversifying, it may be possible to enjoy an inflation-beating income return that improves your financial position year-on-year.

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peterstephens