Why I'd Ditch Cash Deposits and Buy Undervalued Dividend Shares Today

Description

Holding cash has been a popular investment strategy for many years. It offers low risk, as well as an income return which has sometimes been higher than inflation.

However, with interest rates currently being relatively low, the return prospects for cash could be rather disappointing. This contrasts with the income potential, as well as capital growth outlook, for dividend shares.

With many income-paying stocks currently trading on low valuations, now could be the right time to add them to your portfolio instead of holding cash.

Undervalued stocks

Low valuations could mean that investors can obtain high yields and capital growth potential from dividend shares. The uncertain outlook for the global economy has caused central banks to retain a relatively loose monetary policy, with risks such as the impact of tariffs and geopolitical challenges in countries such as the US and China weighing on investor sentiment.

Therefore, while dividend shares now offer far superior income returns compared to cash holdings, they trade on wide margins of safety in many cases. History shows that buying shares while they trade at large discounts to their intrinsic values can lead to improving total returns. As such, now could be the right time to buy income shares.

Income potential

As well as offering high absolute returns, dividend shares also have relatively impressive returnprofiles. For example, the returns on cash have historically been low. This is partly due to savingsaccounts being relatively low risk, with there being a minimal chance of losing money. The result of thisis lower return potential compared to investing in shares, where it is possible to lose significant sums ofmoney.

However, the gap between the returns on cash and dividend shares could widen further in the coming years. As mentioned, risks to the world's economic outlook may mean that interest rate rises are slow, rather than fast. This could lead to dividend shares producing income returns that are many multiples of those offered on cash. When combined with the capital growth potential from buying undervalued shares, this may mean that now is a good time to pivot from cash to dividend shares.

Modest investments

Ditching cash deposits and buying dividend shares may seem like a daunting task. However, opportunities such as tracker funds make the process much simpler. They aim to follow the returns of major indices such as the S&P 500 and FTSE 100, and offer a large amount of diversity for minimal cost.

Additionally, the cost of buying shares has fallen significantly in recent years. Products such as regular investment services mean that building a diverse portfolio filled with a range of companies operating in different sectors is cheaper than ever. This strategy could reduce risk, and also lead to higher returns that are substantially greater than those offered by cash savings in the coming years.

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