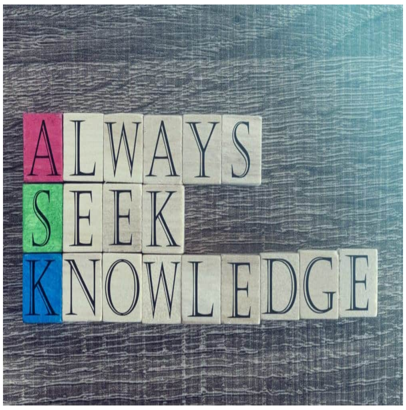

Dividend Investors: This Is the Single Most Important Factor to Consider!

Description

Any dividend investor knows the pleasure that comes with getting that notification that a dividend payment has been made to their investment account.

Of course, a number of factors are at play with respect to whether an equity investment made for income purposes will turn out to be a good one. In the short term, considering what the dividend yield is on any investment is the starting point that matters — knowing what you will be paid next quarter is important. For long-term investors, however, perhaps infinitely more important is the rate at which these dividend-paying companies will increase their payout over time.

Dividend growth is the single most important factor for income-oriented investors with a long-term time horizon (10 years or longer) to consider.

When factoring how much money one will need in retirement and attempting to gauge how to get there, I would encourage every investor to get out their excel spreadsheet and create a timeline of dividend distributions over time, factoring in expected dividend-growth rates and current yield to see the true impact of compounding over the long term to see what I mean.

Royal Bank of Canada (TSX:RY)(NYSE:RY) is a great example of a company that has produced dividends for decades (actually, Royal Bank is one of the oldest dividend payers in Canada, producing dividends for more than a century) and also has an excellent track record of raising its dividend by mid- to high single digits over the long term.

Looking to companies like Royal Bank in the financial sector that have traditionally raised their dividends in lockstep with earnings growth, or companies, like real estate investment trusts, that have traditionally held high payout ratios, are excellent ways to obtain highly sought after dividend growth over time. These companies raise their dividend often by a predictable percentage each and every year (or something that amounts to a long-term average), giving investors a feel for what $1,000 invested today will generate over time.

Using the rule of 72, for example, if one expects a company to raise its dividend in the 7% range over long periods, one can calculate that approximately every 10 years, the dividend yield on the initial invested amount will double. In other words, if one assumes Royal Bank will raise its dividend by 7% in perpetuity, and it has a current yield of 4%, in 10 years, the effective yield on any amount invested today will be 8%; in 20 years, 16%; in 30 years, 32%, and so on.

This compounding effect is dramatic, and the growth rate by which companies continue to hike their dividends can impact one's income dramatically over time. When dividend increases outpace inflation, investors are able to grow their income meaningfully, despite stock price movements, making such equities more beneficial than most bonds, which pay the same yield over long periods of time, as long as these investors do not sell the principal portion of their investment.

Stay Foolish, my friends.

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