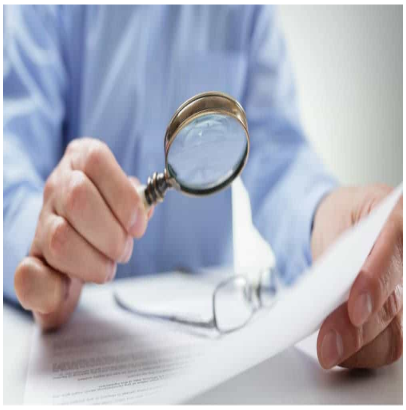

TFSA Investors: You're Probably Focusing on the Wrong Dividend Stocks

Description

You probably already know the power of dividends. Getting a relatively stable payout on your investment every few months is a great way to fund your retirement or build a nest egg for the future. Adding dividend stocks to your Tax-Free Savings Account (TFSA) could help you create a steady stream of tax-free cash flows.

However, not all dividend stocks are the same. In fact, there's a chance you've been accumulating the wrong type of dividend-paying companies in your TFSA portfolio.

The most common way to judge dividend stocks is based on their yield. The higher the yield, the better the return on every dollar you invest, right? While that might seem intuitive, the highest-yielding dividend stocks may actually be the riskiest ones on the market.

Take the top three highest-yielding Canadian stocks at the moment: **Vermilion Energy**, **Chemtrade Logistics**, and **Ensign Energy Services**. Two of them, unsurprisingly, are in the oil and gas sector, which is notoriously unpredictable. Energy stocks have been ruthlessly punished over the past five years, and there's no clear indication that the price of oil will recover anytime soon.

Chemtrade, meanwhile, offers a 12.5% dividend yield, even though the company is losing money on a leverage-adjusted free cash flow basis. The company has nearly $2 in debt for every dollar in shareholder equity and only $11.64 million in cash on hand at the moment. In other words, it's paying out more than it can afford.

In short, the stocks with the highest dividend yields are the most precarious. Investors may have to brace for sudden losses in the stock price or a suspension of the dividend if the company faces a liquidity issue. Instead of focusing on the dividend yield, investors would be better off tracking a different dividend metric.

Dividend growth

Unlike the dividend yield, dividend growth isn't just a sign that the underlying company is profitable and cash flow positive, but also that it is expanding.

A track record of consistently increasing dividends is a signal that the demand for a company's products or services is steadily rising. The demand for electricity, for example, has been predictably expanding for decades, which has allowed well-managed utility companies like **Fortis** to hike dividends every year for 46 years.

Despite its low dividend yield, Fortis could deliver better long-term performance for investors willing to buy and hold the stock for multiple years. Over time, the dividend yield on cost could become more attractive than the risky high-yield stocks mentioned earlier.

In fact, dividend growth accounts for nearly 95% of the long-term returns earned by investors. To leverage the power of dividend growth, investors simply need to add stocks that have already established a series of dividend hikes in recent years. Investors could also add companies that have announced upcoming hikes or more generous dividend policies.

Bottom line

If you're a long-term investor, ditch the hunt for high yields and focus on companies with track records of consistent dividend growth. Dividend increases indicate a healthier business model and robust demand.

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