How to Create a Growing Passive Income With Dividend Stocks

Description

Dividend stocks currently offer significantly more attractive income returns than other mainstream assets. However, building a portfolio of dividend shares that is capable of providing a resilient and growing income in the long run could prove to be a challenging process due to the risks which are present in the stock market.

Here’s how you can limit those risks, and in doing so obtain a resilient and robust income which potentially grows at an above-inflation pace over the long run.

Focus on quality

Perhaps the most obvious means to obtain a growing and robust dividend is to purchase high-quality companies. They may offer stronger dividend growth potential in the long run due to their ability to capitalise on opportunities within their markets. At the same time, they may come with a relatively low risk of enacting a dividend cut, and could offer a more reliable income stream.

Identifying high-quality companies is subjective. However, by concentrating on areas such as debt levels, cash flow and the affordability of a company’s dividends, you may be able to pick the most attractive stocks. Furthermore, focusing on companies which have defensive credentials, in terms of being able to report a solid financial performance during a mix of economic conditions, could lead to a more stable income outlook for your portfolio.

Diversify

Even being able to identify the best companies does not guarantee a growing and robust passive income. Sometimes, stocks can deliver poor financial performance which was impossible for an investor to foresee. Indeed, even the very best investors such as Warren Buffett sometimes make mistakes in terms of the companies they purchase.

Therefore, it is crucial to build a diverse portfolio of income shares, in terms of the sectors in which your holdings operate and the geographies where they do business. This can help to reduce the negative impact of a specific company on your wider portfolio, and may improve the resilience of your passive income.

With risks facing the world economy being relatively high at the present time, such as the ongoing spread of coronavirus, it may be more important than ever to ensure that you have diverse sources of income within your portfolio.

Reinvestment

While it may not always be possible to reinvest the dividends you receive from your portfolio, doing so can improve your long-term financial prospects. Reinvestment allows compounding to maximise your returns, which could ultimately lead to a larger portfolio size in the long run that makes generating a passive income much easier.

As such, spending only what you need to in the short run and reinvesting spare cash wherever possible could be a worthwhile move. It may enable you to enjoy greater financial freedom in older age through benefitting to a greater extent from the generally upward movement of the stock market over the long run.

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peterstephens