Can This 14.1% Yielder Maintain Its Generous Dividend?

Description

Many investors won't even look at companies with double-digit dividend yields because they think such generous payouts are unsustainable.

I prefer a different method. Investors should take the time to look at each individual investment on its own, ensuring that the popular narrative on a stock is actually true.

An interesting thing happens when you crack open the latest annual report: You get an actual snapshot of how the business is doing — something that isn't influenced by popular narratives.

Unfortunately, common belief about a stock is usually right. Investors looking to uncover a hidden gem must turn over a lot of proverbial rocks. But the reward from just one or two success stories can make it all worthwhile.

Let's take a closer look at one such story, a stock offering a dividend yield of more than 14% today. No, that's not a typo. Here's why I think this is a pretty compelling story.

A powerful dividend source

One thing that is keeping **Canoe EIT Income Fund** (TSX:EIT.UN) shares down is many don't really understand how this income fund can afford to pay a 14.1% dividend. And if investors don't understand it, they assume something fishy is going on.

Let me dig under the hood for you.

This income fund isn't all that complicated. It uses a covered call strategy to generate an additional income source on normal blue chip stocks, the types of companies found in most dividend portfolios.

The first step is to sell a call option on the underlying stock. In return for creating a sell obligation for a certain price on a certain date, the option writer gets paid a premium. They get to keep that, no matter what happens.

This trade has two outcomes. The stock can exceed the option price on the date in question, meaning the option writer is forced to sell at the option price. Or it can come up short, which means the option expires worthless. The second choice is the ideal outcome for obvious reasons.

The fund also uses a little debt to really goose returns. This is why it offers such a nice yield compared to other covered call ETFs.

A steady dividend payer

The Canoe EIT Income Fund has been paying investors steady dividends for a very long time. In fact, it has paid its $0.10 per share monthly dividend uninterrupted since 2008.

Yes, the Great Recession forced this fund to cut its dividend. But it's important to note it kept on paying dividends throughout and is continuing to pay dividends during today's market turmoil.

No matter what happens, the underlying covered call strategy is sound. Covered calls are a reliable income source in any market. You just might give up a little upside if the market races higher.

Why it's a compelling buy today

Most Canoe EIT Income Fund shareholders are retail investors who are enticed by the fund's strong yield. Unfortunately, many of these folks really have no idea what they're buying. They're always the first to get spooked when the price goes down.

I couldn't care less what the price of this fund has done: The more important metric is its price-to-net asset value.

At writing, the net asset value is $8.82 per share. The current share price, meanwhile, is a little lower. That currently stands at $8.52 for a discount of about 4%. When markets are stronger, like they were last year, this fund will trade at a 5-10% premium to net asset value.

Patient investors who buy today should get 10-15% upside on today's discount returning to a premium at some point. If we combine that with the succulent dividend yield and the upside potential as the market continues to rally, it all comes together to create a pretty compelling investment opportunity.

The bottom line

Once we take a closer look at this fund, the dividend starts to look a whole lot better. I firmly believe investors looking for a huge dividend yield can do a whole lot worse — and they might even get some interesting capital gains as well.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. TSX:EIT.UN (Canoe EIT Income Fund)

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