Stop Making This Common Dividend Mistake

Description

Dividend investing is a very popular strategy that many people choose to adhere to. In fact, we at the Motley Fool are aware of its popularity and have created our *Dividend Investor* service to help individual investors navigate the stock market.

Unfortunately, investing comes with its difficulties, and dividend investors can still make mistakes. However, remembering one key detail can increase your returns in a big way. That detail is, do not chase the yield. Many dividend investors focus a lot of their efforts on obtaining the highest possible yield in their portfolio, but this mentality can be detrimental.

Take **Vermilion Energy** (TSX:VET)(NYSE:VET) for example. Vermilion is an international oil and gas production company based in Calgary, Alberta. It is a very widely held stock among Canadian dividend investors. When the market reached its bottom in March, Vermilion saw its dividend yield jump to a staggering 74.79%!

Around this time, many dividend investors decided to jump on what appeared to be an amazing deal. Unfortunately, on April 15, Vermilion decided to suspend its dividend program, as it fought to weather the storms caused by COVID-19. Without a dividend to hang onto, many investors had to decide whether to hold or sell their Vermilion position.

Until now, the company has not given any update regarding a reinstatement of the dividend program, leaving a sour taste in the mouths of investors. So, if the dividend yield is not what investors should focus on, what should they look for in a good dividend stock?

Low payout ratio

The payout ratio can be calculated a couple different ways, but generally, it is the ratio between the dividend distribution per share and earnings per share. A lower payout ratio often signals that a company still has lots of room to grow its dividends in the future. This is a particularly important concept for dividend-growth investors.

An example of a company with a low payout ratio is **Canadian National Railway** (TSX:CNR)(NYSE:CNI). It is generally suggested to target companies that have payout ratios under 50%. This company certainly satisfies that requirement by quite a margin as its current payout ratio is a mere 35.45%. Canadian National Railway has been in operation since 1919 and has just under 33,000 kilometres of track spanning from British Columbia to Nova Scotia and into the southern United States.

Its longevity of operation and the large client base that Canadian National Railway has serviced over the years has resulted in an outstanding lead in market share within its industry. This is reflected by a continued increase in revenue year over year. The combination of a low payout ratio and a market-leading position make this company a very intriguing buy and should place it as a core company in any dividend portfolio.

Long history of dividend growth

When looking for a reliable dividend company to add to your portfolio, the most obvious place to look would be at those companies that have a strong history of increasing dividend distributions over many years. **Fortis** (TSX:FTS)(NYSE:FTS) is an excellent example of such a company and is no stranger to features in Fool articles. Fortis is known as a Canadian Dividend Aristocrat, which is a company that has grown its dividend for at least five consecutive years. In fact, the company has the second-longest active dividend-growth streak at 46 years!

This figure is increasingly impressive if you consider that there have been many stock market crashes and four recessions since this streak started! Fortis has been able to continue its dividend-growth streak by meticulously allocating capital every year. In the past decade, its dividend payout has consistently fallen between 61% and 73%. That payout ratio is a bit higher than the 50% suggested earlier. However, the excellent history of dividend growth shown by Fortis through many difficult times suggest that the company may be well positioned to make it through the difficulties the COVID-19 pandemic present.

Conclusion

When deciding on companies to add to your dividend portfolio, try not to focus on the dividend yield. Instead, think of the factors that may allow a company to keep distributing dividends, or even grow them consistently, in the future.

CATEGORY

1. Coronavirus
2. Dividend Stocks
3. Investing

TICKERS GLOBAL

1. NYSE:CNI (Canadian National Railway Company)
2. NYSE:FTS (Fortis Inc.)
3. NYSE:VET (Vermilion Energy)

4. TSX:CNR (Canadian National Railway Company)
5. TSX:FTS (Fortis Inc.)
6. TSX:VET (Vermilion Energy Inc.)

PARTNER-FEEDS

1. Business Insider
2. Msn
3. Newscred
4. Sharewise
5. Yahoo CA

Category

1. Coronavirus
2. Dividend Stocks
3. Investing

Date
2025/06/28
Date Created
2020/06/01
Author
jedlloren