



TFSA Investors: Why You Need to Invest in Dividend Stocks

Description

Dividend investing remains an attractive strategy for long-term investors. It provides investors with an opportunity to benefit from regular dividend payouts as well as capital appreciation. We know that the TFSA (Tax-Free Savings Account) is one of the most flexible vehicles for Canadians. It is an ideal account to hold dividend stocks as both capital gains and dividend withdrawals are tax-free.

While investing in dividend stocks, investors can either withdraw dividends or reinvest them to benefit from the power of compounding. For example, you can buy 100 shares of **Enbridge** ([TSX:ENB](#))([NYSE:ENB](#)) for \$4,310. The Canada-based energy giant pays annual dividends of \$3.24 per share, so you will generate \$324 in yearly dividend payments.

This indicates a dividend yield of a juicy 7.5%. You can use the \$324 to repurchase more Enbridge shares or diversify your investments and buy other quality dividend stocks. Alternatively, you can also withdraw dividends from your TFSA and pay your bills instead with this amount.

You will receive dividends payments regardless of stock prices. In case Enbridge shares move to \$50 in the next year, your total returns will be close to 24%. Another reason why dividend stocks are attractive is the predictability of these payments. Once companies start paying dividends, they intend to continue these payouts for perpetuity.

How to identify quality dividend companies for your TFSA

You need to evaluate company finances before buying their stock. While a company would like to keep paying dividends, these payouts are not a guarantee. Due to low oil prices, **Suncor Energy** [cut its dividend by](#) 55% earlier this year. Last year, networking giant **Nokia** suspended its dividend program indefinitely.

So, you'll want to invest in companies that have strong balance sheets. They need to have enough liquidity and cash flows to sustain the payouts. Let's take a look at the dividend yield and [other key metrics](#) with Enbridge as an example.

One of the most important metrics is a stock's dividend yield. This is represented as a percentage of a company's stock price. Enbridge pays a dividend of \$3.24 per share, and its stock price of \$43.1, indicating a dividend yield of 7.5%. While a high yield is attractive, the company needs to have the ability to sustain and grow dividends.

The payout ratio is another metric for investors to consider while identifying a dividend stock. This ratio is calculated by dividing the dividend per share with earnings per share. A lower ratio indicates the company is retaining its earnings that can be used to reinvest in capital expenditure and fuel long-term growth. A low payout ratio also suggests that the company has enough room to grow dividends over time.

Cash flows per share is also an important metric that needs to be calculated by investors. Cash flows give a better idea of a company's ability to sustain dividends compared to earnings. For 2020, Enbridge expects cash flow per share between US\$4.5 and US\$4.8. Comparatively, its annual dividend payment stands at \$2.3 per share. The cash payout ratio is less than 50% at the midpoint, which makes the stock extremely attractive.

Avoid the dividend trap

Investing in dividend stocks is an exhaustive process. While high-yielding stocks are attractive, they need to support it with strong fundamentals. The best dividend stocks are those that have low payout ratios and that consistently increase payouts over the years.

CATEGORY

1. Dividend Stocks
2. Energy Stocks
3. Investing

TICKERS GLOBAL

1. NYSE:ENB (Enbridge Inc.)
2. TSX:ENB (Enbridge Inc.)

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