Why Dividend Stocks Belong in Every Retirement Plan

Description

Are you planning for your retirement? If so, there's one thing you don't want to overlook, it's dividend stocks.

While you'll want to have a good mix of various sectors in your portfolio, it's also crucial to put some income-generating investments in there. Dividend stocks can generate a recurring stream of income for your portfolio and minimize the need for you to pull capital out to fund your retirement.

One of the biggest, and most morbid, challenges when it comes to retirement planning is estimating how long you might live. In that analysis, you can forecast how much money you'll need each year, how many years you'll live, and then work backward from that to figure out which year you should start withdrawing funds out from your savings to ensure your nest egg will last long enough.

How dividend stocks can help with your retirement

With dividend stocks, you may not need to do that analysis. That's because if you've got enough saved up for retirement, you can potentially live off the dividend income rather than pull your capital out. And so as long as the dividend payments continue, you can generate income for as long as you live and not worry about having to estimate your lifespan or that your savings might not last long enough.

However, the caveat is that you would need to have a fair bit of savings stockpiled to live entirely off dividend income. For instance, **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD) is currently paying its shareholders a dividend of more than 5% per year — and that's higher than normal as COVID-19 and the recession have pushed the bank's shares down more than 15% this year, which, in turn, has increased the yield.

On an investment of $1 million in TD or a group of stocks with similar payouts, you'd be making over $50,000 in dividend income every year. If you're not able to save up that much money by retirement or $50,000 isn't enough to maintain the standard of living you're after, then obviously this won't be a perfect solution.

However, you don't need to rely solely on dividend income, and you can still withdraw some of your capital every year. But with dividend income contributing to your total cash flow every year, you can reduce the amount of money you'll need to withdraw on an annual basis, and that can help make your savings last a whole lot longer.

Another advantage of investing in a dividend stock like TD is that the Big Five bank typically raises its payouts every year. Today, it's paying a quarterly dividend of $0.79. However, 10 years ago its dividend payment was less than half of that, at just $0.305. TD's increased its dividend by nearly 160% during that time, averaging a compounded annual growth rate of 10%.

If the company were to keep raising its dividend payments by 10% every year, then the $50,000 dividend payment on a $1 million investment would grow to $55,000 the following year and to $60,500 the year after that.

By investing early and hanging on to shares of TD (or a comparable stock) until retirement, your dividend income will grow over the years. Although an investment paying 5% in dividends today may not appear significant when looking at your overall retirement plan, years from now it could play a much more important role.

CATEGORY

1. Bank Stocks
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2. TSX:TD (The Toronto-Dominion Bank)

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