How I’d Make a Reliable Passive Income With Cheap Dividend Stocks

Description

The 2020 crash means that many investors are looking outside of the stock market to make a passive income. For example, they may buy property or hold bonds instead of buying cheap dividend stocks at a time when their future prospects are relatively uncertain.

However, dividend shares offer strong income prospects due in part to their high yields. They also have growth potential that could allow you to obtain a robust income in the long run when owning a diverse range of shares in a portfolio.

Dividend affordability for a reliable passive income

Perhaps the most important aspect of obtaining a reliable passive income is ensuring that a company’s dividends are affordable. There is very little to be gained in purchasing a stock that has a high yield, but that is unable to pay shareholders a slice of profit each year.

Analysing a company’s dividend affordability can be achieved by focusing on its dividend coverage ratio. This is calculated by dividing its net profit by dividends paid. A figure of one or above signifies that the company has headroom when making shareholder payouts. A dividend coverage ratio of less than one means that its dividends could be unaffordable unless net profit rises in the medium term.

Buying companies with dividend cover above one may be more important than ever at the present time for investors seeking to make a robust passive income. The economic outlook is very uncertain. Therefore, seeking a margin of safety when assessing a company’s dividend affordability may lead to a more reliable income outlook.

Financial strength and competitive position

Passive income investors may also wish to consider a company’s financial strength when assessing its investment potential. Companies with strong balance sheets that contain modest amounts of debt may be better placed to survive weaker operating conditions. They may also be less likely to cut dividends in response to weaker sales prospects, since they have the financial means to ride out a difficult economic period.

Similarly, companies with a competitive advantage over the peers may be able to produce higher profitability in the long run. For example, they may have a unique product or a cost advantage over rivals that translates into higher profit growth and a more robust dividend.

Diversification

A diverse portfolio of shares may offer a relatively resilient passive income. For example, a portfolio of 30 companies that operate in different sectors may produce a more stable income return than a portfolio of less than 10 businesses that all operate in similar industries.

Diversifying is cheaper and simpler than ever. As such, any investor who wishes to make a reliable income return from cheap dividend shares after the stock market crash can build a portfolio containing a broad range of companies without incurring large commission costs. Doing so could enhance your returns and provide greater stability in the long run.

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Date
2025/08/25
Date Created
2020/11/15
Author
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