



How to Build a Safe Passive-Income Portfolio

Description

Building a passive-income portfolio implies doing active work upfront to set up an automated system. This way, it would require little work to manage the investment portfolio. We'll use dividend stocks to build a safe passive-income portfolio.

The first thing to do is to automate the contributions. For example, if you get paid at the end of every month, you can set up your chequing account to automatically transfer, say, 10% of your paycheck to your investing account(s).

Buying the right dividend stocks

For a passive-income portfolio, you want to ensure you're buying the right dividend stocks. After all, not all dividend stocks are suitable for passive income.

Specifically, you want dividend stocks that generate predictable/stable/growing earnings or cash flow. Understandably, it's only rational there could be earnings/cash flow stumbles in some years (like this pandemic year).

You want the kind of companies that grow in most years and are willing to increase their dividends as a way to share profits with their shareholders.

These dividend stocks should also have a safe payout ratio. Depending on the industry in question, the payout ratio could be higher or lower. A simple check you can do is compare a dividend stock's payout ratio to that of its peer group or its historical levels.

For instance, if a dividend stock has been increasing its payout ratio over the last few years and the ratio is getting stretched, the dividend would be less safe.

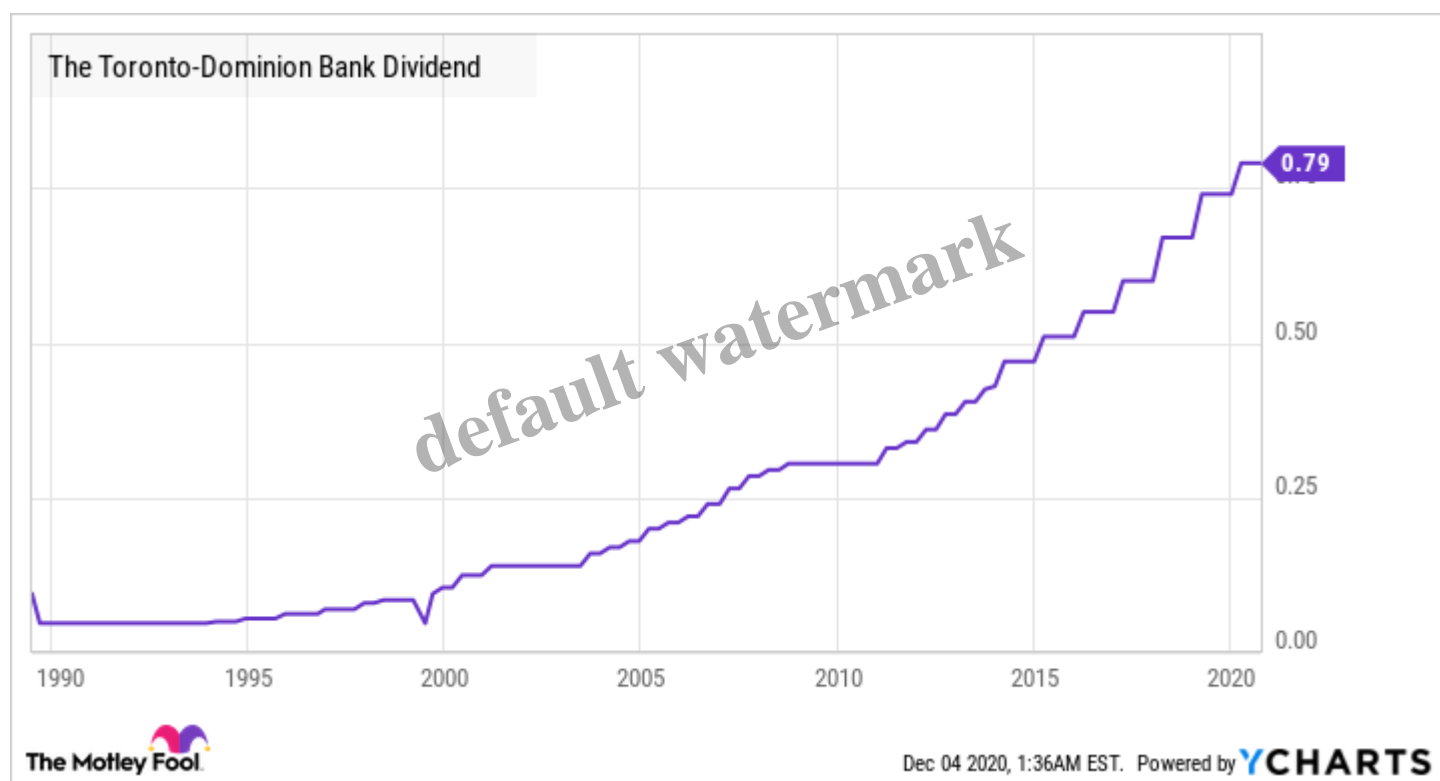
Let's get to some dividend stock examples!

Toronto-Dominion stock

Toronto-Dominion ([TSX:TD](#))([NYSE:TD](#)) stock increases its earnings and dividend in most years. During recessionary years, it's inevitable that, as a bank, it's going to experience earnings cut from a higher level of bad loans.

In this case, TD would be required to set aside more money as a cushion for these loans. Therefore, you see in the chart that around the 2008/2009 recession, TD stock maintained its dividend.

So, the bank could end up freezing its dividend around this recession as well. We'll know if that's the case in late February when it declares its next dividend.



Data by YCharts. TD stock's dividend history.

TD stock will work as a nice passive-income investment if investors buy the stock when it's relatively cheap to lock in a good yield. This means buying the stock at a margin of safety, which is always ideal.

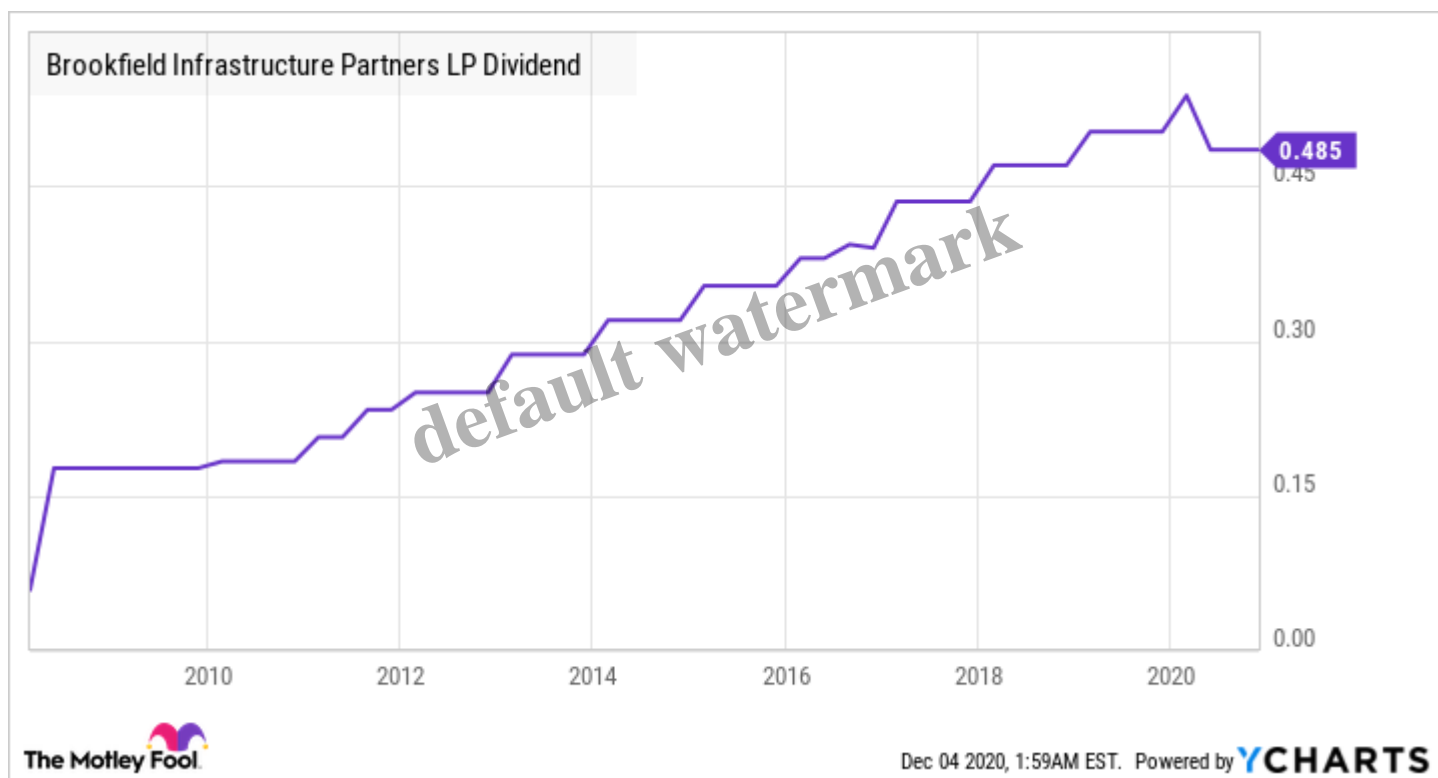
Right now, the stock is still trading at a discount of more than 10% from its normalized level. Additionally, it yields close to 4.5%, which is still quite attractive. So, TD stock is still a decent buy for passive income.

Its payout ratio may be higher than normal this year, but it's usually under 50% in a normal macro environment.

Brookfield Infrastructure

Brookfield Infrastructure Partners ([TSX:BIP.UN](#))([NYSE:BIP](#)) has a global portfolio of high-quality assets across utilities, transport, energy, and data infrastructure. The utility is another dividend stock you can consider for passive income. It generates highly predictable cash flow that's driven by regulated and contracted revenues.

Management sees [BIP](#) growing its cash distribution by 5-9% per year. Given its track record, the utility should have no problem achieving that target. Notably, the chart shows a dip in BIP's dividend this year. It's not a dividend cut but that it spun out BIPC shares in Q2 (and as a result also spun out some of its cash distribution to BIPC shares).



BIP Dividend data by YCharts. BIP stock's dividend history.

Because BIP's business has been super resilient, BIP's payout ratio should be more or less the same as normal — between 60% and 70% of funds from operations. Currently, it yields 3.8%.

The Foolish takeaway

If you automatically set aside a portion of your income and invest in safe dividend stocks like TD and BIP during dips or corrections, you'll lock in nice dividend yields at a margin of safety. It'll be rewarding to keep track of your passive-income stream every month and [watch it grow](#).

CATEGORY

1. Bank Stocks

2. Dividend Stocks
3. Investing
4. Stocks for Beginners

TICKERS GLOBAL

1. NYSE:BIP (Brookfield Infrastructure Partners L.P.)
2. NYSE:TD (The Toronto-Dominion Bank)
3. TSX:BIP.UN (Brookfield Infrastructure Partners L.P.)
4. TSX:TD (The Toronto-Dominion Bank)

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