How I'd Make a Passive Income With Cheap Dividend Stocks

Description

Cheap dividend stocks could offer a generous passive income relative to other mainstream assets. Their yields are significantly higher than the returns available on other income-producing assets, in many cases.

Therefore, building a diverse portfolio of stocks that have affordable dividends and the potential to raise them over the long run could be a shrewd move. It may lead to a worthwhile passive income that stays ahead of the returns on assets such as cash, bonds and property.

Making a passive income with cheap dividend stocks

The 2020 market crash means that there are many cheap dividend stocks available to purchase today. Due to their disappointing share price performances, their yields may be high in many cases.

While this may make them seem attractive at first glance, looking beyond a company's dividend yield could be very worthwhile. In other words, checking that it is affordable given the current challenging operating conditions could be a logical move. There is little point in buying a high-yielding stock if its dividends cannot be paid in 2021 and beyond.

Analysing the affordability of shareholder payouts among cheap dividend stocks can be achieved by checking the dividend coverage ratio. It is calculated by dividing net profit by dividends. A figure in excess of one suggests that the current level of dividends is affordable, and may have a higher chance of being maintained in an uncertain operating environment.

Dividend growth opportunities

Cheap dividend stocks could offer a growing passive income in some cases. Certainly, they may struggle to raise shareholder payouts in the short run if their operating conditions are poor. However, the past performance of the world economy suggests that stronger GDP growth is likely to be ahead. This could mean that company profits improve, and management confidence strengthens so that they pay a larger dividend.

Clearly, assessing the likelihood of dividend growth is very subjective. It is heavily linked to a company's profitability. However, by investing in industries that can benefit the most from an economic turnaround, or those sectors that enjoy long-term growth trends, an investor may increase their chances of generating a rising income from cheap dividend stocks.

Reducing risk for a stable passive income

It may be tempting to buy a small number of the best cheap dividend stocks available today. They may offer the highest yields, the best growth potential and the most stable passive income.

However, diversifying across a wide range of businesses can reduce portfolio risk. It means that there is less reliance on a small number of companies from which to obtain an income. A diverse portfolio of dividend shares may offer greater stability, as well as a more resilient income that rises at a faster pace over the long run.

Clearly, cheap dividend stocks could fall in price in the short run due to the challenging economic outlook. But, over time, their total return prospects appear to be bright.

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