Why I'd Buy and Hold Cheap Dividend Stocks for More Than Just a Passive Income

Description

Many investors may view today's cheap dividend stocks solely from a passive income perspective. In other words, their high yields provide a generous income return and little else.

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However, undervalued income stocks could deliver impressive capital returns alongside a passive income. Their low prices may equate to capital growth potential – especially as low income returns available on other mainstream assets push investors towards dividend shares.

Capital growth opportunities from cheap dividend stocks

Despite the 2020 stock market rally, there are a wide range of cheap dividend stocks available to purchase today. In many cases, they face challenging operating conditions in the short run that have caused investors to demand a wide margin of safety. While this may limit their scope to deliver capital growth in the short term, over the long run they could benefit from improving operating conditions as part of a global economic recovery.

Therefore, buying them now while they trade at a discount to their intrinsic values could be a shrewd move. It may enable a long-term investor to lock-in low valuations across the stock market for high-quality businesses that have the financial capacity to survive further operating challenges. Over time, today's cheap stocks could experience stronger financial performances and improving investor sentiment that leads to high capital returns for investors.

A lack of passive income appeal elsewhere

Cheap dividend stocks offer a significantly more attractive passive income opportunity than other mainstream assets at the present time. For example, obtaining an income return that is positive on an after-inflation basis has become more difficult over the past year for bondholders and savers. Theymay even experience a loss of spending power should interest rates remain low and inflation rise in the coming years.

Meanwhile, property investment may produce disappointing income returns over the next few years. High house prices and a struggling economy may produce low yields that fail to improve significantly.

This may increase the appeal of cheap dividend stocks, thereby raising demand for income shares. The end result could be rising share prices – especially if interest rates remain at low levels. Since policymakers seem to be more concerned about the economy's outlook rather than maintaining modest levels of inflation, it would be unsurprising for a loose monetary policy to remain in place over the coming years.

Reducing risk from undervalued dividend shares

Of course, cheap dividend stocks may experience further difficulties in the short run. Their operating conditions could deteriorate further in the coming months. As such, it is important to buy those companies with solid financial positions and affordable dividends. Doing so may reduce risk and lead to a higher passive income, as well as a larger capital return in a likely stock market rally over the long term.

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