Why I'd Buy Dividend Shares Now to Capitalise on the Stock Market Recovery

Description

As well as providing a generous passive income, dividend shares could deliver impressive capital growth in a stock market recovery.

Their high yields could become increasingly appealing to income investors with limited options among other mainstream assets. Furthermore, the low valuations of many income shares could mean they offer good value for money and significant scope for gains over the long run.

With a large proportion of the stock market's past total returns having been generated from the reinvestment of dividends, buying income shares could be a sound means of outperforming the index.

The increasing popularity of dividend shares

While dividend shares have always been a means of obtaining a passive income, today they could prove to be the best option by some distance for many investors. That's not only because many dividend stocks have high yields, but also because income returns available elsewhere are relatively low.

The loose monetary policies pursued over the past 10+ years, as well as falling interest rates across major economies following the 2020 market crash, mean that the returns on cash and bonds are extremely disappointing. For many people, they are too low to even consider when it comes to obtaining an income from their capital. As such, they may be pushed towards dividend stocks in order to generate a worthwhile passive income.

This situation may mean that demand for dividend shares increases over the coming years. Certainly, interest rates will rise at some point in future. However, that could be many months, or even many years, away. The result of this could be rising demand for income shares that pushes their prices higher.

Total return potential

As mentioned, many income shares appear to offer good value for money at the present time. Since the 2020 market crash, many investors have focused on growth stocks, rather than dividend shares. This could mean there is scope for large capital gains from a portfolio of income shares that enables them to outperform the wider stock market.

The historic returns of indexes such as the FTSE 100 shows that a large proportion of total returns have been derived from the reinvestment of dividends. As such, investors who do not need, or desire, an income in the short run could buy income stocks and reinvest the shareholder returns received. This may enable them to earn a relatively high return in the coming years.

Clearly, it is important to diversify across a wide range of dividend shares. Although many of them are solid businesses with sound financial positions, the uncertain outlook for the economy may hold back their performances in the short run. However, buying a range of them could produce higher returns, as well as lower risks, to benefit from a long-term stock market rally.

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