Buffett Says Bonds Are No Longer Attractive: Buy These 2 Stocks Instead

Description

Warren Buffett unveiled some harsh truths of the current economy in his 2020 annual letter. The investment world has changed. Fixed income, which was once a passive investors' paradise, is no longer a good investment. Buffett says, "Fixed-income investors worldwide – whether pension funds, insurance companies or retirees – face a bleak future." If bonds are no longer attractive, what is the next destination for a bond investor?

Before you look at another alternative, understand why Buffett is bearish on bonds.

Buffett: "Bonds are not the place to be these days"

When you invest, you sacrifice your current purchasing power to get a higher purchasing power in the future after adjusting for inflation.

What made fixed-income attractive in the olden days was its high yield. But over the years, the 10-year Treasury bond yield has declined 94% from 15.8% in September 1981 to 0.93% at present. At 0.93% yield, your money can't fight inflation that is over 1.5%. By putting your money in bonds, you are actually losing value. Buffett also noted that countries like Japan and Germany have negative yields, which means investors pay to keep their money in bonds.

This weak bond yield had a ripple impact on fixed-income securities. Some insurers and bond investors tried to compensate "the pathetic returns" of bonds by purchasing risky loans. Seeking even riskier borrowers could destroy the fixed-income market in the future.

Buffett: A juicier alternative to bonds and fixed-income securities

Investing in risky loans is not an alternative to the near-zero bond yield. A better option is equity. I do agree that equity carries a higher risk than fixed income, as shareholders share both profits and losses of a company. But good dividend stocks with stable business models and predictive cash flows are a much better alternative than risky loans.

Buffett prefers utilities and energy firms for their regular dividends. Recently, he started favoring telecom firms as he sees higher future cash flows from 5G. Listen to Buffett, and instead of parking your funds in fixed income, put them in below two stocks.

Enbridge stock

For years **Enbridge** (TSX:ENB)(NYSE:ENB) has enjoyed the loyalty of dividend lovers. The company has been increasing its dividend per share at an average annual rate of 10% for the last 26 years. Time and again, it has proved its resilience to an economic crisis. Even during the pandemic crisis, Enbridge increased its dividend per share by 3% in 2021.

Enbridge stock has a dividend yield of 7.33% at present because the company increased its dividend per share and the pandemic reduced its stock price. Unlike fixed income, your principal investment could fall when the stock price falls, but that is a risk it compensates for with a high dividend yield.

Moreover, Enbridge is a company that will continue to remain profitable in the coming 10 years thanks to its long-term contracts to supply oil and natural gas.

BCE stock

Walking on similar lines, **BCE** (TSX:BCE)(NYSE:BCE) is another low-risk dividend stock. It will continue to remain profitable in the coming 10 years. BCE has the largest communication infrastructure in Canada. This infrastructure is already generating stable cash flows. The company is now investing in expanding its 5G footprint. This will increase its cash flow and accelerate its dividend growth.

The company increased its dividends at a 6.4% average annual rate in the last 10 years. It currently has a dividend yield of 6%.

Dividend stocks or fixed income securities?

Enbridge stock is down 16% from its January 2020 high. If you invested $5,000 in the stock then, now it has declined by $780 to $4,220. But its 8% dividend yield last year earned you $400 in dividend income.

Assuming Enbridge increases its dividend at an 8% annual rate, your $5,000 can earn you a total dividend income of $5,300 in the next 10 years. Similarly, with a $5,000 investment in BCE, you can earn a total dividend income of $3,950 in the next 10 years, assuming a 6% dividend growth rate.

Even if your principal investment falls because of fluctuation in stock price, your 10-year dividend income has already doubled your money. You are net positive in the long term.

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