Need Income? 3 Tips for Building Passive Income With Dividend Stocks

Description

You never know when life will throw something your way. Last year, the pandemic that reduced many people's income. It's therefore super helpful to have a passive income stream on top of your job's income, especially if you're the breadwinner.

When it comes to building a passive income stream, here are three key tips to keep in mind: high income, dividend safety, and principal safety.

High income

Investors who are building a passive income to supplement their active income are looking for juicy passive income.

What makes an income passive? An income is passive when you don't have to do any work to generate the income. Dividend investing requires doing initial research on the underlying companies. Then, if you picked the right dividend stocks, you could essentially hold the stocks forever for passive income.

What makes an income juicy? Interest rates are low right now. The best five-year GIC rate is 1.8%. Investors who are willing to take a little more risk can certainly do better than that by going with proven dividend-growth stocks.

The Canadian stock market yields about 2.92% at writing. You might consider a juicy yield as +4.38%, which is 1.5 times 2.92%. Of course, a bigger yield is always desirable, as long as the dividend is safe.

Dividend income safety

It doesn't cut it if you buy a juicy dividend stock with a yield of 10%, only to experience a dividend cut the following month. Therefore, on your journey in finding high income, consider the safety of the dividend as well. Ideally, you want your dividend stocks to grow their dividends.

For example, **Enbridge** (TSX:ENB)(NYSE:ENB) has a massive yield of close to 7.4%. However, its dividend doesn't look like it's in jeopardy.

First, Enbridge has a nice track record of increasing its dividends, specifically, for 25 consecutive years and counting.

Second, management estimates it will grow its distributable cash flow, from which it pays out dividends, by 5-7% per year through 2023. A company's growing earnings or cash flow are always good protectors of dividends.

Third, the company is paying out about 69% of its distributable cash flow as dividends. This ratio is within the company's target of 60-70%.

Fourth, the company's adjusted EBITDA, a cash flow proxy, has remained super resilient through economic cycles. Otherwise, the stock couldn't have maintained a dividend-growth streak through three recessions!

Safety of principal

When investing for passive income, you also should limit losses of capital as much as possible. After all, you need capital to generate passive income. Most big-dividend payers are value stocks, which fits perfectly in the strategy of value investing, in which you aim to buy stocks when they're cheap.

To protect the safety of your principal in these stocks, aim to buy shares when the underlying stocks are at least reasonably valued. And ideally, you would want to buy at massive discounts (like during a market downturn).

Enbridge is well covered by analysts, who conveniently provide a consensus 12-month price target of $51.76 per share. This means the dividend stock is discounted by about 12% at the recent quotation of $45.35. So, ENB stock is at least reasonably valued.

The Foolish takeaway

By following the three tips above, I hope you'll be able to build a secure passive income stream to begin supplementing your active income. This way, you should feel much more financially secured going forward!

Who knows? If you keep working at it, you could even replace your active income with your passive income stream. It'll only take an interest in stock investing, and diligent saving and investing.

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