How I'd Generate TFSA Passive Income From Dividend Stocks in a Low-Rate World

Description

It's tough to be a passive-income investor these days. Fixed-maturity debt securities are ridiculously unrewarding with their negative real yields, and they're probably no longer worthy of holding in your TFSA (Tax-Free Savings Account) for the long haul.

The 60/40 stocks-to-bonds allocation doesn't make nearly as much sense as it used to; passive-income investors are going to have to make a choice: either settle for meagre returns or increase one's risk appetite by allocating a greater mix of one's TFSA to "risky" securities like equities and REITs.

Passive-income investors need to adapt to these challenging times

I have nothing good to say about bonds these days. The days of double-digit coupons of the early 1980s are gone. Either you have to take risks to get the passive income you need, or you'll lose ground to inflation, which is slated to spike due to all this stimulus.

Rather than settling for less, I think passive-income investors should weigh their options. There are many ways to reach for yield without risking one's shirt to do so. There are compelling bond proxy dividend stocks out there that can help one raise the yield bar without necessarily raising the risk bar. Given how expensive and unrewarding bonds have become, I'd argue that "risky" bond proxies are far less risky, especially at today's critical market crossroads.

Looking beyond bonds for TFSA passive income

If you're more of a passive investor looking for income options, there are a slew of wonderful "covered call" ETFs out there that can actually give one a raise without increasing one's risk exposure. Numerous one-stop-shop, covered-call ETFs can allow one to get the tax-free passive income they need without having to worry about what's troubling the broader markets.

In this piece, we'll have a look at two conservative options for TFSA investors who are fed up with bonds and their meagre yields. Without further ado, consider **Fortis** (TSX:FTS)(NYSE:FTS) and **BMO Covered Call Utilities ETF** (TSX:ZWU) — two compelling options that can help passive-income investors cope with the low-rate environment that's likely to remain for another several years.

Fortis

Fortis is my favourite bond proxy on the **TSX Index**. The stock has been under considerable pressure for most of 2020 due to COVID-induced disruptions. Despite COVID's impact, nothing fundamental has changed. You're still getting a nice 3.8%-yielding dividend that's slated to grow at an above-average rate every year, making the risk-off name a great pick for your TFSA passive-income fund. The utility can support such stable dividend growth through its capital spending plan, which paves the way for greater growth versus most other utility companies out there.

Sure, Fortis stock is boring, but it's times like these, when volatility is rampant, where boring is beautiful. So, if you're sick of bonds and losing ground to inflation, Fortis is a compelling way to get the best of both worlds: stable capital appreciation and a growing payout.

The ZWU

If you're a young investor who's looking to grow your wealth over the long run, the ZWU and other covered-call ETFs are not for you. In essence, the ZWU and other covered-call ETFs trade upside potential for premium income upfront. The labour-intensive process of writing such covered calls is reflected in the high MER, which is currently at 0.72%.

The ZWU yields an impressive and safe 7.6%. If you're a passive-income investor who couldn't care less about appreciation and would rather have the extra income, the higher MER is well worth paying up for. If you believe that we're headed for a stagnant or bear market, the ZWU is poised to outperform its non-covered-call counterpart. Given stocks tend to go up over the long run, though, the ZWU is likelier to underperform the longer you hold onto it, making the ETF only suitable for particular types of passive-income investors.

For retirees and overly conservative investors, the ZWU may be worth picking up. Just make sure you understand the pros and cons of such a specialty-income ETF.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:FTS (Fortis Inc.)

2. TSX:FTS (Fortis Inc.)
3. TSX:ZWU (Bmo Covered Call Utilities ETF)

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1. Investing

Date
2025/07/28
Date Created
2021/03/23
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