



How to Create Passive Income with Dividend Stocks

Description

So, you want to create a passive income that you can rely on for years to come? One simple way to do so with a solid foundation is through quality dividend stocks.

Here are three qualities that dividend stocks in a passive income portfolio should have.

Secure your passive income with earnings or cash flow quality

You want every stream of your passive income to be safe. You would therefore choose dividend stocks with a track record of stable (ideally growing) earnings or cash flow. In addition, the payout ratio must also be reasonable.

Fortis ([TSX:FTS](#))([NYSE:FTS](#)) stock is a prime example of a dividend stock that provides quality earnings. As a regulated utility, the Canadian Dividend Aristocrat is able to post highly predictable returns on its investments.

You would never see the stock's earnings per share (EPS) falling by a whole lot even during the worst years. When it does experience fallen earnings in a year, it more than makes up for it in the subsequent year. That's a prompt recovery!

Fortis stock's payout ratio is estimated to be about 73%. That's a comfortable ratio for the company that sees itself growing its dividend by about 6% per year through 2026.

Buy dividend stocks with juicy dividend yields

Alimentation Couche-Tard (TSX:ATD.B) is a wonderful company, but it wouldn't suffice for passive income investors who need juicy income now!

Unless you have years to wait for its dividend to grow (or you expect outperforming price gains), you wouldn't buy Couche-Tard here.

The global convenience store consolidator with roadside fuel's 10-year dividend growth rate is almost 27%. Assuming it grows its dividend by 20% per year for the next five years, an investment with a yield of 0.80% will turn into a yield on cost (YOC) of just under 2%. If you wait another five years for the same dividend growth rate, the YOC will turn to nearly 5%.

Fortis stock offers a yield of nearly 3.7%. In a little more than five years, its yield on cost would be approximately 5.2%.

What's a juicy enough yield for passive income investors? The **TSX** stock market yields about 2.7%, you might want your passive income to generate an initial yield of at least 4.1% (or 1.5 times 2.7%) for the extra work you put in [managing your dividend stock portfolio](#).

“Price is what you pay. Valuation is what you get.”

The above quote is by legendary value investor Warren Buffett. You want to buy quality, juicy dividend stocks when they're attractively valued. By doing so, you'll boost the passive income you receive. Stock prices have nothing to do with valuation. Certainly getting a grasp of the concept of value investing will help boost your income and returns.

For instance, I find [Fortis stock](#) to be quite attractively valued whenever it yields 4% or higher. The valuations of quality dividend stocks are more easily estimated than highly unpredictable stocks that can be super volatile.

The Foolish takeaway

A dividend portfolio is one of the simplest income investments you can get.

After identifying a diversified group of 20-30 dividend stocks with the three qualities discussed, you can do very little work for portfolio maintenance. Essentially, you could be a buy-and-hold passive income investor who just needs to focus on the buying — what to buy and when to buy — if you're still in the accumulation phase.

If you're already at retirement and have accumulated enough assets, your dividend stock portfolio could generate all the passive income you need.

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1. Dividend Stocks
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