Alert: This Invisible Tax Could Eliminate 100% of Your Passive Income

Description

It's no secret: passive income is notoriously difficult to generate right now. Investors have few good options. Most investments now offer paltry yields or are subjected to high volatility. The days of living on rental income or savings accounts are quickly disappearing.

Investors must now seek out high-yield dividend stocks to generate passive income. Fortunately, the Canadian stock market offers plenty of robust dividend stocks in reliable sectors such as energy and telecoms. Unfortunately, these seemingly predictable yields face an invisible threat: inflation.

Here's a closer look at how your passive income could quickly be eroded by the forces of economic change.

Inflation destroys purchasing power

At the moment, inflation is running red hot. The annual rate of inflation is 4.4% right now – higher than it's been in 18 years! If this pace continues, all of your assets and income streams could lose *half their real value* in less than 16 years.

Economists and experts don't expect inflation to remain this high for that long. This phase is seen as "transitory." However, the near-term impact of this trend is palpable. For instance, nearly all dividends generated in the Canadian market this year have already been offset by inflation.

The **S&P TSX 60 Index** offered a 2.48% dividend yield over the past twelve months. Inflation is roughly twice as high, which means investors *lost purchasing power* in real terms in 2021.

Even high-profile dividend stocks like **Fortis** (TSX:FTS)(NYSE:FTS) struggled to catch up. The utility giant delivered a 3.9% dividend yield over the past month. All of that passive income was consumed by the higher cost of living in 2021.

What can investors do?

If inflation remains persistent for longer than expected, investors don't have many good options.

One way to beat inflation is to focus on capital gains. Real estate investment trust **RioCan** (TSX:REI.UN), for instance, offers a dividend yield that's on par with inflation: 4.3%. However, the stock price is up 36% year-to-date amid a booming real estate sector, completely offsetting the impact of this invisible tax.

Another strategy is to focus on dividend *growth.* Fortis is a good example of this too. The company has promised steady dividend growth of about 6% a year for the next few years. After all, the company has managed to boost its dividends for 47 years, so there's no reason to believe this trend won't continue. That means Fortis can sustain the value of its payout despite this inflationary cycle.

Bottom line

Most Canadian stocks offer dividends that are far below the rising cost of living. This means investors are experiencing an invisible tax on their wealth and income. There are a few good ways to avoid this.

Investors could focus on comparatively riskier stocks such as RioCan or dividend growth stocks like Fortis to sustain their passive income.

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Date
2025/08/21
Date Created
2021/11/02
Author
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