Passive Income: How to Make Money in Your Sleep With Dividend Stocks

Description

You don't have to start a business to earn dividends. You can become a part-owner of publicly traded companies to start earning passive income now! Simply buy shares of solid dividend stocks through your online brokerage.

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Not all dividend stocks are suitable for passive income, though. Here are a few things to take note of when choosing.

Does the dividend stock provide a juicy yield?

Generally, investors should beware of high-yield stocks. These stocks could have fallen off a cliff, pushing their yields to 8% or higher, before cutting their dividends. However, it's not to say that large stock price declines will lead to dividend cuts for sure.

For example, during the pandemic market crash, **Manulife** (TSX:MFC)(NYSE:MFC) dropped to as low as $12 per share for an initial yield of about 9.3%. However, it maintained its dividend throughout the ordeal, and as soon as the regulator loosened restrictions, it immediately boosted its dividend.

What's considered a juicy dividend yield? Interest rates are at historical lows. The best five-year, non-redeemable GIC offers a rate of 2.65%. This is considered a risk-free rate. For the risk that investors bear from dividend stocks, it's natural for investors to demand a higher yield. Lowell Miller describes a juicy yield as 1.5 to two times the market's yield in *The Single Best Investment.* Applying this to the Canadian market that yields about 2.5%, a juicy yield would be 3.75% to 5%.

In any case, when you come across a dividend stock, especially one that pays a juicy yield, always check to make sure the dividend is safe.

The dividend stock should provide safe dividends

A number of factors can help keep a dividend stock's payout safe, including a fundamentally strong company, the nature of its earnings or cash flow, and its payout ratio. A fundamentally strong company has a solid balance sheet. A stock with an S&P credit rating of BBB- or higher is considered investment grade. Some dividend stocks have highly stable earnings or cash flows that help in protecting their dividends. Different industries have different sustainable payout ratios. For example, dividend stocks sensitive to market cycles should maintain a lower payout ratio to protect their dividends. Always compare the key metrics of a company to those of its peers.

Manulife has a solid S&P credit rating of A. We experienced a short recession last year, during which the life and health insurer experienced a 7% drop in adjusted earnings per share, which is not too bad given the situation. Importantly, it was able to maintain its quarterly dividend during a highly uncertain economic time partly because it maintains a sustainable payout ratio. Its 2020 payout ratio was about 41% of earnings.

Can you hold the dividend stock if it turns south?

If you're used to holding low- to no-risk investments, you might feel like it's a roller-coaster ride holding dividend stocks. You should be prepared to experience stock volatility and market downturns. Furthermore, have the ability to hold and ride through tough times when things turn south.

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> "If you aren't willing to own a stock for 10 years, don't even think about owning it for 10 minutes."
> *Warren Buffett*

The beauty of holding dividend stocks for passive income is knowing that you have carefully chosen them for safe, juicy yields in good *and* bad times.

CATEGORY

1. Dividend Stocks
2. Investing

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1. Editor's Choice

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