How to Pick the Best Dividend Stocks? Don’t

Description

Picking the best dividend stocks is essential for a robust passive income strategy. However, that’s easier said than done. Here’s why creating and maintaining the right dividend portfolio is tougher than it seems and what investors should consider doing instead.

Dividend portfolio construction

Passive income investors already know the basics of dividend investing. You pick robust companies with steady cash flows that deliver healthy dividend payouts. However, this strategy doesn’t take the business cycle into account. In other words, the best dividend stocks today could be cutting payouts and publishing profit warnings in a few years.

We saw this play out during the pandemic. Commercial real estate investment trusts (REITs) were some of the best dividend stocks in Canada. However, lockdowns and the work-from-home movement pushed many of these REITs to cut dividends.

Similarly, energy and bank stocks are the best dividend stocks at the moment. Inflation is high and interest rates are likely to rise, so these stocks could deliver stellar dividends in 2022. But will this sustain these payouts for five or 10 years? What does the world look like in 2025?

You could rebalance your portfolio every few months, but this strategy is time-consuming and error-prone. If you’re looking for truly “passive” income perhaps its better to bet on a fund that actively rebalances the portfolio for you.

Passive income ETF

Exchange-traded funds (ETFs) with an active investment strategy deserve a spot on your watchlist. **Horizons Active CDN Dividend ETF** (TSX: HAL) is a great example. The fund aims to hold a portfolio of dividend stocks with payouts that are higher than the market average. The portfolio is rebalanced based on the economic cycle. In fact, the team also invests beyond Canada, into the U.S. when they find attractive opportunities.

HAL is an actively-managed fund and invests mostly in North American dividend companies. TSX-listed companies account for more than 90% of its holdings, while U.S. dividend companies account for about 4%.

Despite its modest size, it is one of the best performing ETFs on the market. HAL registered about a 20% gain in 2021. Since its inception in 2010, the ETF has returned 8.3% annually. The outperformance is a testament to the management team's ability to follow the market cycle successfully.

The current portfolio

Horizons Active CDN Dividend ETF offers a well-balanced portfolio for any investor seeking truly passive income opportunities.

Some of HAL's top-weighted sectors include utilities at about 22% and financials at about 17%. In addition, no stock accounts for more than 5% of its holdings, thereby ensuring the ETF is not susceptible to increased volatility from one holding.

Despite being one of the smallest, Horizons Active CDN Dividend ETF pays a reasonable dividend yield of about 3.05%, ideal for generating robust passive income. This isn't the highest dividend yield on the market, but the team has proven its ability to generate capital gains to augment total returns over time.

The biggest downside to this ETF is that it comes with a rather high management expense ratio of 0.67%. That's higher than some of its peers. Despite the high expense ratio, Horizons Active CDN Dividend ETF is still an exciting pick for investors looking to put their retirement on autopilot.

Bottom line

Active ETFs like HAL allow investors to make truly passive income over time.

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vraisinghani