Easy-Mode Dividend Investing: Simply Buy and Hold Forever!

Description

Are you busy with your life and would rather spend less time investing for your future? I get it! You can greatly reduce your time spent on your dividend investing by switching on the easy mode. That is, simply buy and hold forever. This way, you only need to make buy decisions and not have to think about selling.

Research has shown that about a third of stock market returns come from dividends anyway. So, it makes sense to hold dividend stocks. If you don't hold, you lose that potentially consistent income-generating power. If you pick the right buy-and-hold forever stocks, your dividend investing strategy can be a mostly passive-income endeavour!

Here's how you can go about this easy-mode dividend investing.

Identify a basket of buy-and-hold-forever dividend stocks

Dividend stocks that are candidates for buying and holding forever should have earnings quality and dividend safety. What is earnings quality? The underlying businesses' earnings should be stable in most years and persistently grow over time. This helps improve the safety of the underlying dividends.

What's a safe dividend? Having a strong dividend history is a good start, but investors should also screen the financial health of the underlying business and ensure the dividend stock's payout ratio is sustainable.

For example, **Fortis's** (TSX:FTS)(NYSE:FTS) earnings are highly stable and persistently growing over time because of the nature of its regulated utilities. Therefore, it's also able to maintain a relatively high payout ratio, which is expected to be about 76% this year.

You can compare a dividend stock's payout ratio to that of similar peers or the industry average. If it's way out of whack, you should look into why that's the case. Typically, the higher the payout ratio, the less safe a dividend is.

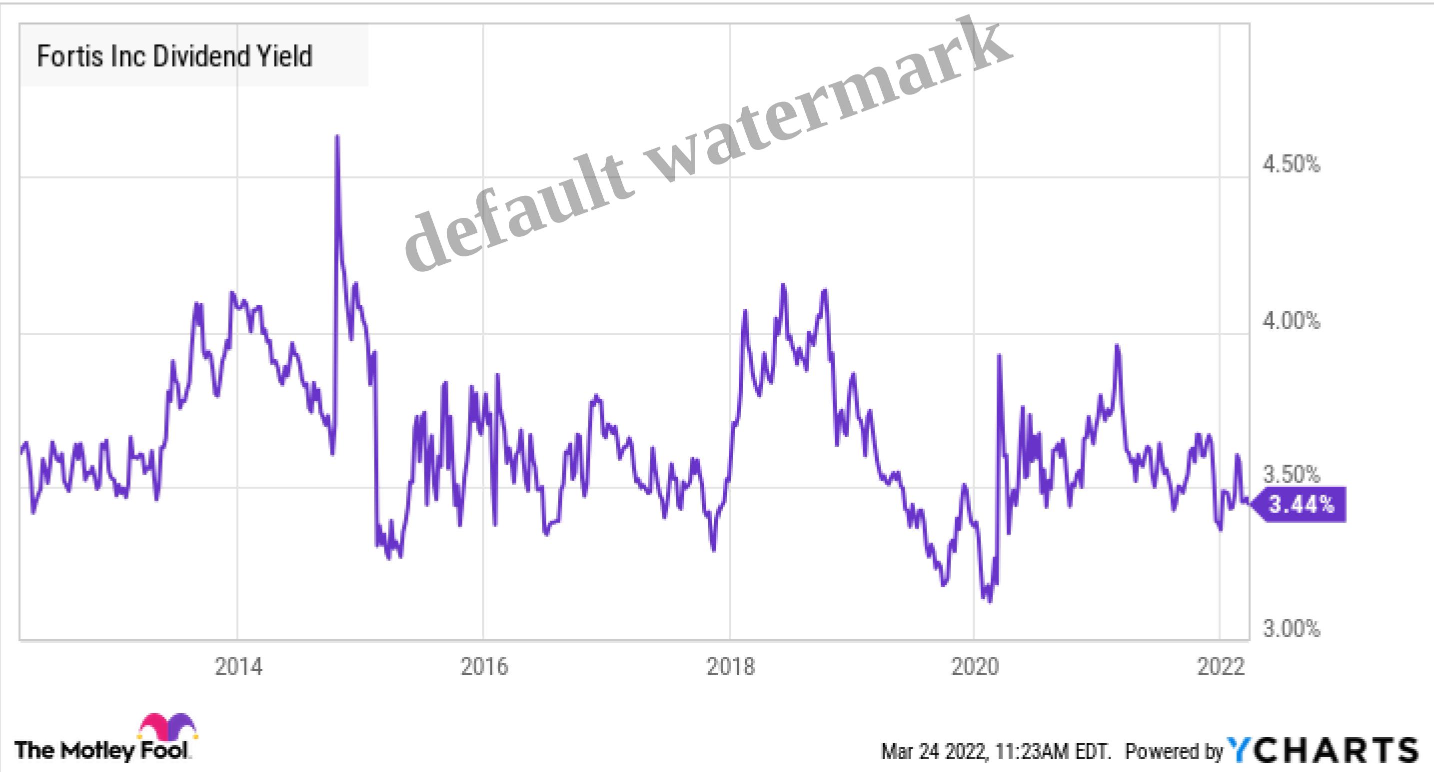
Let’s take **Magna International** (TSX:MG)(NYSE:MGA) as another example. Because of its sensitivity to the business cycle, its earnings are more unpredictable. Consequently, it maintains a much lower payout ratio than the likes of Fortis. Magna’s payout ratio is estimated to be 29% this year.

It doesn’t mean one or the other is a better investment. However, investors would need to be able to stomach greater volatility in Magna than Fortis. It’s especially essential for investors to aim to buy Magna at the low end of a cycle.

Determine when you should buy

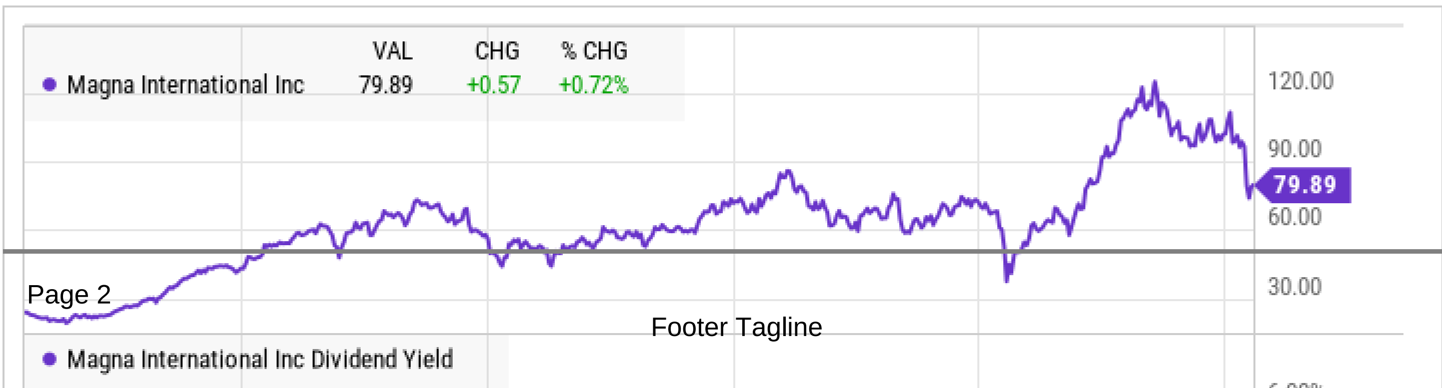
Valuation is key to maximizing your dividend income generation and total returns. In other words, aim to buy dividend stocks when they’re cheap or, at least, don’t overpay for them. Since Fortis has earnings quality and nearly a half-a-century record of increasing dividends, investors can use its dividend yield as a guidance for making purchases.

Fortis’s 10-year yield history suggests that it’s a good buy at a yield of close to 4%.



FTS Dividend Yield data by YCharts

For Magna, you can see that it’s not as clear cut. Its yield also had an abnormal spike due to the pandemic market crash. However, the cyclical stock recovered incredibly strongly after that. From the yield range, investors can consider buying close to a 3% yield.



>MG data by YCharts

Hold your dividend stocks forever

If you'd purchased Fortis and Magna stocks 10 years ago, you would be sitting on a yield on cost of about 6.3% and 7.2%, respectively. During the period, Fortis and Magna increased their dividends at a compound annual growth rate of about 4.4% and 10.2%, respectively. Because of Magna's higher overall earnings growth, it has been able to increase its dividend at a higher rate.

In this example, taking greater risk in buying Magna stock 10 years ago would have delivered greater income and total returns. Magna's 10-year total returns were roughly 12.2% versus Fortis's 7.6%. However, that's not always the case. And investors need to examine each dividend stock carefully before considering buying and holding forever.

CATEGORY

1. Dividend Stocks
2. Investing

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2. NYSE:MGA (Magna International Inc.)
3. TSX:FTS (Fortis Inc.)
4. TSX:MG (Magna International Inc.)

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