Caution: Don't Buy These 3 Dividend Stocks for Passive Income

Description

There are tonnes of dividend stock ideas out there. However, not all dividend stocks are suitable for passive-income investing. This article points out three types of dividend stocks that passive-income investors may wish to filter out.

Commodity stocks

Some commodity stocks pay dividends. However, investors should be careful, as some don't pay safe dividends. Because the underlying businesses of these stocks depend on commodity prices to cooperate in order to do well, most commodity stocks could cut their dividends during challenging times.

That's not to say that you can't make money from investing in commodity stocks, including oil and gas stocks, but investors should not buy them and expect to collect passive income, no matter how enticing their yields become during downturns. If it's an energy stock that historically reports volatile earnings and has high debt levels, investors have got to be extra careful.

For example, you may remember **Baytex Energy** that paid a dividend as late as 2015. Although its balance sheet has improved, the stock still trades at a much lower level and still pays no dividend now, despite high oil prices.

Dividend stocks with no dividend history

Even when a company has strong and stable profitability, it doesn't necessarily have to pay out dividends. Some companies find better use for their cash, such as to fund growth projects. Passive-income investors should note that other than declared dividends that must be paid, dividend stocks do not have to pay out dividends in the future if management chooses not to do so.

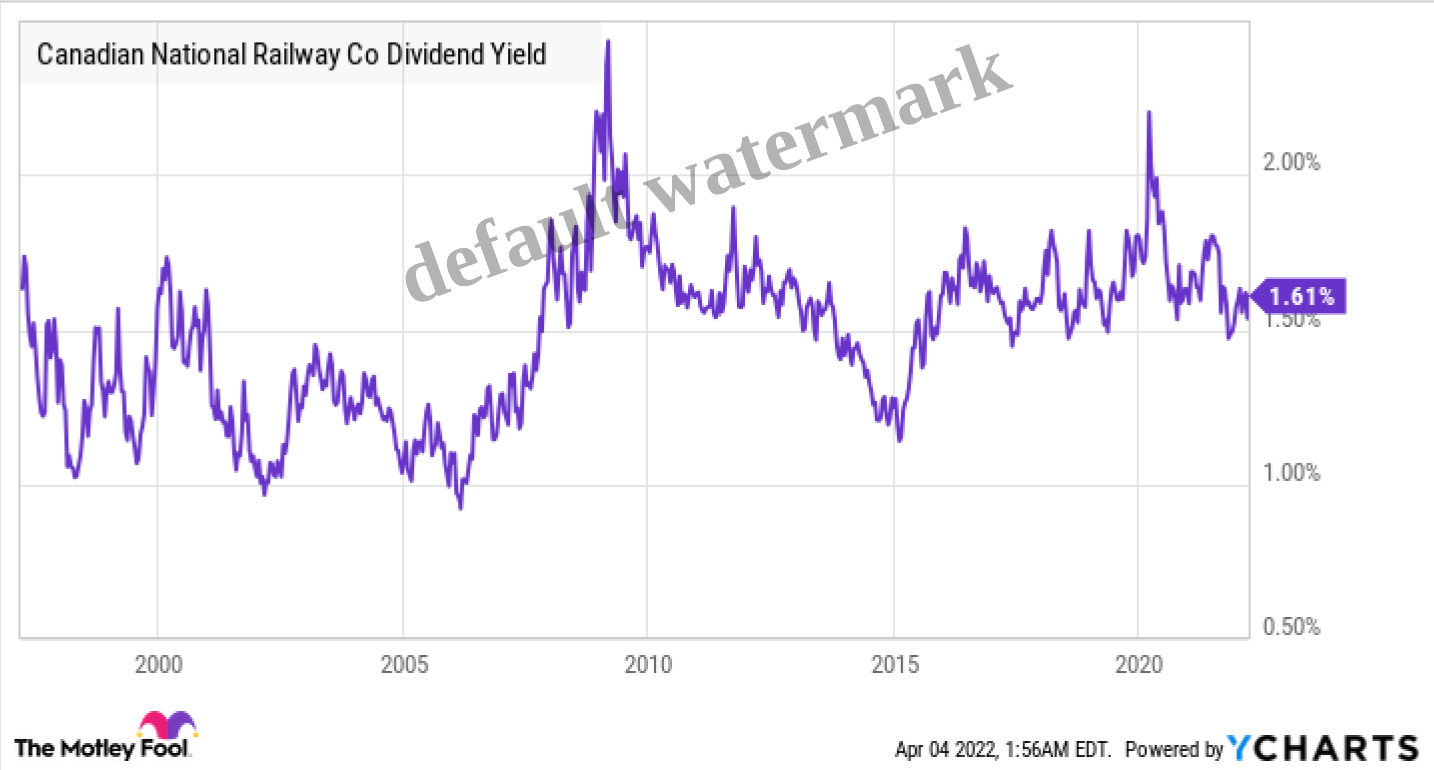
That said, typically, companies that have a history of paying dividends, say, five years or longer, have a greater tendency to continue paying dividends. The longer the dividend streak, the more likely a dividend stock will continue paying dividends. That's because these dividend stocks want to attract long-term investors that tend to keep their stocks relatively stable.

Therefore, a dividend stock that generates stable earnings *and* has a track record of paying dividends will likely pay safe dividends that are more suitable for passive income. So, be extra cautious around new dividend payers or dividend stocks that have cut dividends in the past.

Low-yield stocks

Many passive-income investors want passive income now. Naturally, they want bigger dividends for more income today. It's not to say that low-yield dividend stocks won't pay passive income, but they're not as enticing for those looking for current income.

For example, **Canadian National Railway** (TSX:CNR)(NYSE:CNI) is a wonderful business that has a wide moat. When bought at a reasonable valuation, long-term investors are pretty much guaranteed a return of over 10% per year. Unfortunately, the stock yields less than 2% most of the time.



CNR Dividend Yield data by YCharts

Interested investors need to be patient to allow time for the dividend to grow into a meaningful passive-income stream. Buyers of the quality growth stock from about 10 years ago saw their yield on cost grow from less than 2% to more than 7% today, equating to total passive income of about $3,992 on a $10,000 initial investment. The same investment in **Enbridge** stock would have resulted in $5,927 of passive income.

Notably, low-yield but quality stocks like CNR are still popular among investors who don't need current passive income, as their long-term returns can outperform given the grow potential and low risk of the investments (at the right valuation). For instance, in the 10-year period, CNR stock delivered annualized returns of 15.7% versus Enbridge’s 7.7%.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. NYSE:CNI (Canadian National Railway Company)
2. TSX:CNR (Canadian National Railway Company)

PARTNER-FEEDS

1. Business Insider
2. Koyfin
3. Msn
4. Newscred
5. Quote Media
6. Sharewise
7. Smart News
8. Yahoo CA

PP NOTIFY USER

1. kayng
2. kduncombe

Category

1. Dividend Stocks
2. Investing

Date
2025/07/25
Date Created
2022/04/05
Author
kayng