Dividend Investing 101 for Beginner Investors

Description

Our savings are worth less in the future. $1,000 today will be worth much less 10 years from now. Assuming a 3% inflation rate, $1,000 today will be worth only $744 in a decade. Therefore, it's a smart move to invest excess cash. The goal is to at least keep pace with inflation and thereby maintain your purchasing power. Cash that you don't need now but plan to spend within the year may be placed in short-term corporate bonds, money market funds, and short-term GICs to gain greater interest income.

If you have a long-term investment horizon, you can explore dividend investing in stable businesses. Assuming a 3% inflation rate, you can double your purchasing power on an annualized return of 6% on your investments.

Fortis stock example

Fortis (TSX:FTS)(NYSE:FTS) stock is one of the best dividend stocks to get beginner investors started in dividend investing. Over the last decade, Fortis stock delivered total returns of about 9% per year. In the period, it increased its earnings per share (EPS) and dividend per share (DPS) by roughly 4.4% and 5.9% per year, respectively.

It's not as safe an investment to buy now, though. Because it has increased dividends at a faster pace than its earnings, its payout ratio increased from 69% to 79%. Additionally, the stock's valuation expanded from a price-to-earnings ratio of about 19.5 to 24 times. Lately, it seems investors have piled into low-risk stocks, including Fortis. New investors should be cautious and wait for a pullback in the regulated utility stock to at least the $58-per-share level before reconsidering it.

Sun Life stock is a better value

Sun Life (TSX:SLF)(NYSE:SLF) stock appears to be a better value today for a dividend yield north of 3%. Specifically, at $68.56 per share at writing, it yields 3.85%. Since 2012, the life and health insurance company increased its EPS and DPS by roughly 8.8% and 4.8% per year, respectively. In the period, it delivered total returns of about 15% per year. Its payout ratio is estimated to be sustainable at about 43% this year. At approximately 11.3 times earnings, the dividend stock is reasonably valued and should be able to increase its dividend by 5-7% per year.

Just last month, Michael Sprung picked Sun Life as one of his top picks on *BNN*:

> "Sun Life has very strong financials and management team. A rising interest rate environment will benefit the company. It's able to consistently grow earnings above its 8-10% goal. The catalyst to increase share price might come from its improved U.S. operations. We're expecting dividend increases in the future."
> *Michael Sprung, president of Sprung Investment Management*

The Foolish new investor takeaway

The key idea is to buy stable and growing businesses with safe dividends when they trade at reasonable (or bargain) valuations. You don't want to overpay for stocks, or your investment could be stuck making low to negative returns in the near term. Even with a long investment horizon, you still want to make good use of every dollar of your savings.

Bargain valuations usually don't occur, unless there are market-wide corrections, which often come with heightened macro uncertainties. At those times, it would be best to shop for solid dividend stocks to invest in for the long haul.

CATEGORY

1. Dividend Stocks
2. Investing

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2. TSX:FTS (Fortis Inc.)
3. TSX:SLF (Sun Life Financial Inc.)

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Date
2025/08/15
Date Created
2022/04/08
Author
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