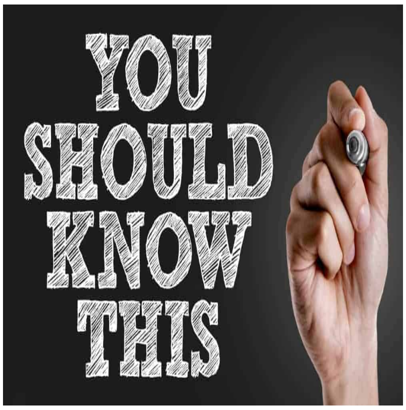


# The Advantages and Disadvantages of Buying High-Yield Dividend Stocks

## Description

Investing in dividend stocks can be highly appealing for some investors, considering you start to receive cash flow from your investment almost immediately. And often, when looking at making investments, investors look at buying high-yield stocks in order to earn as much passive income as possible.



Seeing an 8% yield or even more can certainly be a compelling reason to invest. However, while the yield may attract you to research a specific stock, it should be one of the last reasons to consider an investment.

Before you buy any stock, it’s crucial to make sure that the company is sound, and it’s one of the best opportunities for you to put your money to work today. And often, a high yield can be an early sign of trouble for stocks.

If you’re thinking of buying high-yield dividend stocks, here are three advantages and disadvantages of doing so and what you should consider.

## What are the advantages of buying a stock with a significant dividend yield?

The first reason is apparent. High-yield stocks allow you to receive more capital and at a faster pace over time. This allows you to build a cash position quicker and put that money back to work in new stocks to take advantage of compound interest.

However, another advantage that goes hand in hand with receiving more income from higher-yield stocks is the risk of holding the investment lessens.

That doesn't mean there's no risk at all. But when stocks start to pay back some of their earnings to investors, the risk of earning a profit is less than holding businesses that don't pay a dividend at all, where you're solely counting on capital gains.

And, of course, a higher yield can mean that the stock is undervalued and could offer upside potential. When the price of a stock falls, the yield it offers rises. Therefore, when you see a stock with a high yield, it could be ultra-cheap.

## What are the disadvantages of buying high-yield dividend stocks?

Although high-yield stocks can be a sign that a stock is cheap, often, these stocks are cheap for a reason, as investors fear more trouble ahead.

So, it's crucial to understand that a high yield can often be a red flag. That doesn't mean you shouldn't research the stock, just keep in mind that there is likely a reason the dividend yield is so high.

Another disadvantage of buying high-yield stocks, and a reason why they might be cheap in the first place, is that they could be at risk of a dividend cut, or they could still be overvalued and expected to fall further in price.



This is something crucial to watch out for. Buying a stock with an 8% yield is meaningless if the company needs to cut the dividend in half or the stock is still considerably overvalued and likely to fall another 30%.

So, although buying high-yield dividend stocks can look appealing, you don't want to buy an underperforming company.

One last factor to consider is that when companies pay out more cash, they have less to invest in growth. And often, high-yield dividend stocks will be paying out most of their cash flow.

This is crucial, because even if the company is a high-quality business and the dividend is safe, a stock that yields 8% may not offer much capital gains potential.

For example, royalty companies like **Pizza Pizza Royalty** aim to payout 100% of their earnings after taxes. So, typically, unless the entire brand is seeing a major increase in sales, the value of Pizza Pizza's stock won't change all that much.

Its stock price may fluctuate according to market conditions, but over the long run, if it does offer investors growth, it will likely be minimal.

If you're buying stocks hoping to earn returns higher than what these high-yield dividend stocks are offering, you may have to look elsewhere, likely for a lower-yield stock.

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