New Investors: The 2 Best Options To Earn Regular Passive Income!

Description

If you're new to investing and want to earn passive income, here are two ways to do it:

1. Dividends/interest.
2. Covered calls.

Which passive income source is best for your investment portfolio depends on your investment objective and risk profile. Dividends and interest are cash payouts paid by security issuers (stocks and bonds, respectively) in exchange for holding their securities—we use the term "dividend" with respect to stocks, and "interest" with respect to bonds. A stock with a consistent dividend payout can grow your income steadily but slowly.

Covered calls are options that pay you a certain amount of money called a premium to agree to sell your stock at a set price in the future. Premium income can be higher and grow your income faster, but is less predictable.

Let's explore these two main ways that you can earn passive income from your investments, and compare their strengths and weaknesses.

Dividends/interest

Dividends and interest are regular cash payments you receive from investments. Dividends from stocks are usually paid out once per quarter; interest from bonds is often paid twice per year. There are also bonds that pay you your entire return at the end of the holding period. Unlike stocks, bonds have "maturity dates" when everything is paid back to you. A common bond-like investment is a GIC, an instrument that pays you back a little more than what you paid in after some months or years have passed.

Dividend stocks typically pay more than bonds do. Currently, the **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD) stock yields 4.12%, which is a much higher yield than you'll get on the average GIC. There are GICs by **Equitable Bank** that yield 5% or more, but they have very long terms. Dividend stocks usually crush the returns available on short-term GICs. Also, dividend stocks offer growth. If a company does well, its stock will likely go up, and it may increase its dividend, too. TD Bank, for example, has raised its dividend by about 9% per year over the last five years. At a 9% growth rate, your payout doubles after eight years.

Covered calls

Another way to earn passive income from your investments is to write covered calls. A covered call is a kind of option where you own a stock, and you agree to sell it to someone in the future if it hits a set price. The buyer pays you a small fee, called a premium, for agreeing to sell the stock to them. Let's say you own 100 shares of TD, and you decide to write covered calls with a $100 strike price (i.e., the price target where you have to sell). If the markets are offering a $1 option premium for TD stock at $100, then you'll collect $100 up-front. If TD stock goes to $100, you have to sell all your shares. If it doesn't, then you simply keep the fee, collecting passive income in the process. This strategy is a somewhat complex, and isn't for beginners, but you can access it through funds like the **BMO Canadian High Dividend Covered Call ETF,** where a team of professionals execute the strategy for you.

Foolish takeaway

Of the two main ways of earning passive income in the stock market, collecting dividends is definitely the easiest. You can simply buy a diversified, broad market index fund, and collect cash payouts. The returns on such a strategy are not sky-high, but they're usually positive. Writing covered calls is a harder strategy, but it can be lucrative. If you're a beginner, you can get started by buying a fund that deploys this options strategy.

CATEGORY

1. Dividend Stocks
2. Investing

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1. NYSE:TD (The Toronto-Dominion Bank)
2. TSX:TD (The Toronto-Dominion Bank)

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