3 Easy Tips for Passive-Income Dividend Investing

Description

Dividend stocks pay out billions of dollars of dividends that are up for grabs. Any Canadian can buy shares of dividend stocks and earn passive income. However, not all dividend stocks are good passive income candidates. Here are some tips that can help you identify and build a solid passive-income stream.

Dividend safety

Investors can observe multiple metrics to check for dividend safety. The more boxes checked, the safer the dividend of the underlying dividend stocks.

First, check for profit stability. Dividend stocks with volatile earnings have riskier dividends. To improve the safety of your passive income, seek businesses that have stable profits through economic cycles.

Second, check for sustainable payout ratios. Compare a dividend stock's payout ratio with that of the industry average. It should align with (if not be lower than) the industry average.

For example, **Royal Bank of Canada** (TSX:RY)(NYSE:RY) has low earnings volatility. Over the past 20 years, its earnings have a long-term upward trend. Its payout ratio is set up to be about 44% this year, which aligns with its typical range of 40-50%. This is also the range of the industry average.

Third, investors can also check that the company does not have too much debt by comparing liquidity and debt ratios either to a base year (e.g., 2019) or to the industry average.

One common liquidity ratio to look at is the current ratio. As an example, **Fortis's** recent current ratio is 64% versus 2019's 62%. Its recent debt-to-asset ratio was 64% versus 62% in 2019. Those are similar levels. Its regulated utility peer **Emera's** recent current ratio and debt ratio are 67% and 71%, respectively. So, nothing jumps out.

A “big enough” dividend

Since you are seeking passive income, you want “big enough” dividends. You can borrow Lowell Miller’s rule of considering a big dividend yield as one that’s 1.5 times to two times that of the market. Right now, the Canadian stock market yields about 2.88%. So, a big enough yield would be 4.32%-5.76%.

So, of the three stocks mentioned, only Emera almost pass this test by having a yield of about 4.31% at writing. Of course, you can follow this rule as strictly or loosely as you like depending on your need for current income and market conditions.

Less management needed

For passive-income investing, you want as less management as needed for your dividend portfolio. Therefore, passive-income investors should populate their diversified dividend portfolio with wonderful businesses that grow their profits over time.

RBC, Fortis, and Emera are good considerations. To maximize your income, you should focus on buying dividend stocks opportunistically, such as during bear markets.

For example, during the 2020 pandemic market crash, RBC stock fell to as low as $70, below eight times earnings. The stock dipped close to 3% yesterday after reporting its fiscal third-quarter results, but it still trades at below 11 times this year’s expected earnings.

The stock is not as cheap as it was when it was at pandemic market crash levels, but that kind of once-in-a-blue-moon buying opportunity is hard to come by. RBC stock is, at worse, fairly valued today. The safe dividend stock yields almost 4.2% and can still deliver total returns 11-13% per year over the next three to five years. This estimated income and return may still meet the expectations for many passive-income investors.

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