This Incredibly Common Mistake Can Come Back to Bite Dividend Investors

Description

When investors look for dividend stocks, they often focus on dividend yield. This is technically a very important thing to consider, because stocks with a higher dividend yield could provide you with a stronger source of passive income. However, it's far from the most important metric to consider. In my opinion, metrics like a stock's dividend payment history, ability to raise dividends, and payout ratio are more important to consider. I'll discuss three TSX stocks that could be great choices for a dividend portfolio.

Look for companies with a long history of paying dividends

The first thing that investors should consider is whether a stock has been paying its shareholders a dividend for a long time. This is important, because it can tell you how a company fares in different market conditions. For instance, does that company tend to cut its dividend during recessions? Or does it have a history of providing a reliable dividend regardless of what the economy looks like?

Take **Bank of Nova Scotia** (TSX:BNS) for example. This stock has been paying its shareholders a dividend in each of the past 189 years. It's important to note that Bank of Nova Scotia's dividend hasn't always grown over that period. However, unlike some other popular dividend stocks, Bank of Nova Scotia has been able to pay its shareholders reliably through several different periods of economic uncertainty. That includes the World Wars, the Great Depression, the Great Recession, and the COVID-19 pandemic, among many other events.

Choose stocks that can raise distributions year after year

Next, investors should look for companies that have a history of raising dividend yields. This is important to consider, because if a stock's dividend doesn't grow over time, then investors could fall behind inflation and lose buying power. One way to find companies that excel at raising dividend distributions is by consulting a list of Canadian Dividend Aristocrats. These are companies that have raised distributions for at least five consecutive years.

Of that group, **Fortis** (TSX:FTS) stands out. It currently holds the second longest active dividend-growth streak in Canada (48 years). The company forecasts that it'll be able to continue raising its dividend at a compound annual growth rate of 6% through to at least 2025. If you're looking for a stock that could pay you handsomely for holding shares, consider Fortis.

Consider a company's payout ratio

Finally, investors should consider whether a company has a low payout ratio. This is important because it can speak to a stock's ability to sustain dividend distributions and raises. If a company operates with a high dividend payout ratio, then its dividend may not be sustainable. This is because companies with high payout ratios don't have a lot of room to continue paying dividends if their business takes a hit.

Canadian National Railway (TSX:CNR) is an excellent example of a company that has a low payout ratio. As of this writing, it maintains a payout ratio of 37%. Generally, I look for companies that operate with a payout ratio of 50% or lower. Canadian National's payout ratio falls way under that limit. I'm confident that this company could continue to raise its dividend over the coming years.

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