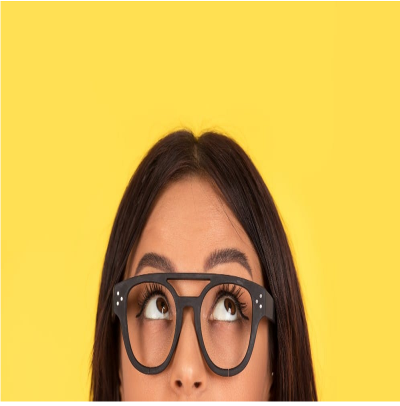

Bonds or Dividend Stocks: Which Is Better for Fixed Income?

Description

An incoming recession might have many investors wondering where they should put their cash to keep it safe. And, of course, even more might be wondering how they can actually *make* money during a recession.

While there's always the (terrible) option of finding that one growth stock that outdoes the rest, there's a much easier solution. But even this has proven a debate. Investors continue to be swarmed by opinions on whether bonds or dividend stocks are better during a recession.

Today, let's look at the benefits and downfalls of both options, and discuss some options for investors to consider.

Benefit of bonds

If you're unfamiliar with bonds, as many new investors might be after years of owning growth stocks, let's do a mini dive in. Governments and corporations give out bonds as basically a trade. You're investing in the government or corporation and, in return, receive a guaranteed fixed-income rate. This lasts for as long as you're invested over a defined period of time.

So, let's say you invest in a corporation that has a maturity date of three years. During those three years, the company must pay out the interest rate to their holders. But these rates are quite low and inversely correlated to interest rates. So, if rates go up, bond prices go down, and the reverse is true. So, with a recession coming and rates likely to fall, many are flocking to bond yields to income during a recession.

Now, this is great during a recession, but it's afterwards that's the problem. As interest rates fall, bonds will go up. But when those rates stabilize, bonds will fall once more. Plus, you'll likely see very little income from your investments at that point.

For example, **BMO Short Federal Bond Index ETF** (TSX:ZFS) offers monthly distributions currently at 1.99%. That's compared to a weighted average of 1.57% over an average term of 2.67 years. As you can see then, the yield is already rising, providing you with rising, fixed income at a time when shares are dropping.

Benefits of dividend stocks

Dividend stocks *could* provide you with fixed income, but it could also come at a cost. While bonds tend to climb higher and higher during a recession with fixed income on top, dividend stocks could fall even further. That's even if earnings are doing well, as investors are looking to keep hold of their cash for after a recession, needing it to foot the bills in the meantime.

That being said, you can usually find some great deals on dividend stocks during this time and look forward to income while you wait — as long as it's the *right* company. It's important to note that a dividend could definitely be cut during a downturn, so you want to choose safe stocks that have a long history of increases.

In that case, I would choose an infrastructure company. In Canada, one of the safest investments you can make is with **Canadian Utilities** (TSX:CU). It's the only Dividend King on the TSX today, with a yield at 4.85% as of writing. Shares are now up 4.4% in the last year, and yet it's trading near value territory at 16.89 times earnings.

Granted, Canadian Utilities stock is a medium-risk investment compared to a low-risk investment like bonds. However, if you're a long-term investor you're bound to receive your income and see returns rise. Shares are up a solid 53% in the last decade, a compound annual growth rate (CAGR) of 4.37% as of writing. So, again, it's not crazy high but not risky either.

Bottom line

It's a great time to invest in bonds *and* dividend stocks, but only if you know where to look. Long-term bonds may not be a great option; after a recession, they tend to drop as interest rates rise. As for dividend stocks, not every dividend stock offers a deal like Canadian Utilities. So, make sure to always discuss your options with your financial advisor.

CATEGORY

1. Investing

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