Passive Income: Avoid High-Yield Stocks. Buy This Instead

Description

Do you want to build passive income that accumulates in your account each and every month? It's a worthy goal, but there are some pitfalls you'll need to watch out for should you decide to pursue it. Passive income is definitely real, but the general rule is that you have to invest a lot of money to get very much of it.

Ignoring this rule is what gets people into trouble. In the quest for passive income, many people buy stocks and funds with extreme yields. Theoretically, you only need to invest $100,000 to get $10,000 in passive income each and every single year. The problem is that 10% yields tend to be risky and unsustainable. In fact, ultra-high yield stocks tend to be riskier than stocks as a whole. In this article, I will explore a different type of stock you can buy as an alternative to high-yield stocks.

Dividend-growth stocks

Dividend-growth stocks are stocks that gradually increase their dividends over time. In some cases, they have high yields, but in most cases, they don't. These stocks tend to be a little safer than their high-yield peers. They don't pay out too high of a percentage of their earnings as dividends, generally speaking. So, their yields are lower than those of high-yield stocks, but they also have a lesser risk of losing investors' money.

A textbook example

A great example of a dividend-growth stock is **Canadian National Railway** (TSX:CNR). It's a dividend-growth stock with a 1.85% yield. That yield might sound too small to even be worth considering, but think again. Not only does CNR have the potential for capital appreciation, like most stocks do, but it also has a stellar dividend track record.

Over the last five years, CNR has raised its dividend by 11.60% per year. In the last 12 months, it raised it by 19%! If a dividend increases by 11.6% annually, it only takes around six years to double. So, CN Railway's dividend could go much higher, if its future looks much like its past. Rail transportation is an economically indispensable industry, and CN only has one big competitor in Canada, so it could keep up its earnings and dividend growth well into the future.

You don't always have to choose!

One point about high-yield stocks and dividend-growth stocks is that you don't always have to choose between them. Sometimes, you find yield and growth together in the *same stock*.

Consider **Enbridge** (TSX:ENB). This is a dividend stock with a 6.55% yield today, and a 12.7% dividend growth rate (per year over 10 years). It's a pretty good combination of both yield and growth.

Enbridge is a pipeline company that transports oil all across North America. This industry isn't very competitive, with only a handful of major players. This gives Enbridge a lot of room to collect revenue without having to compete on prices. It typically locks customers in on long term (eight to 20 years) contracts and collects fees from them whether the price of oil goes up, down or sideways. It's a pretty solid company with a great dividend track record.

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