CHARTING RETIREMENT

Should retirees buy dividend stocks instead of bonds?

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In some ways, BCE is the ultimate dividend stock. It is a national institution that has been paying a steady dividend for the past 25 years.

But with its shares recently in freefall, investors might be wondering if dividend stocks like BCE are a safe-enough place to invest their retirement nest egg. More specifically, should retirees who need a steady source of investment income hold dividend stocks instead of long-term government bonds? (For the sake of completeness, I will add 91-day T-bills as a third option).

Chart One

To answer the question with historical data, I picked the year 1999 as a starting point and created both a bond portfolio and a stock portfolio. I picked 1999 because it was a very good year for government bonds as yields were high and falling, which is good for bonds.

It was, however, a very poor starting point for stocks, considering what happened in the years immediately following: the bursting of the dot-com bubble in 2001 and 2002, the great recession of 2008-09, and the short-lived but dramatic fall in prices in the early months of the COVID pandemic.

The bond portfolio consisted of $50,000 in long-term Canada bonds which I will assume were bought and held for 25 years. By buying the bonds in 1999, the yield at the time of purchase of over 6 per cent could be locked in for the next 25 years.

The stock portfolio – also worth $50,000 – consisted of the shares of three companies: a telecom

These were not necessarily the best performers in their respective sectors but were representative of reliable dividend payers in those sectors, and picking three provided some much-needed diversification.

In spite of the difficult factors stocks faced at the start, Chart 1 shows that the stock portfolio produced far more annual income than the bond portfolio, at least after 2004.

(There was never a great time to be in T-bills for longer than a year or two, so we can ignore it.)

The change in market value over time is also important. Chart 2 shows the market value of the stock portfolio is far greater than that of the bond portfolio.

Chart Two

What does all this mean? Well, historical results are no guarantee of future performance, but in this case, it should inspire some confidence in dividend stocks. Remember we skewed the example in favour of bonds when picking the start date, and stocks still won.

I would conclude that if your investment horizon is very short and you can't afford a capital loss, you might simply put all your money into bonds or GICs or maybe T-bills.

That way, you don't lose sleep holding on to a stock like BCE. If your investment horizon is 10 to 20 years – true of most retirees under 70 – consider a significant holding in the shares of major companies with a steady revenue stream and a proven dividend history.

As for Generation X or Y investors, virtually all of the savings should go into stocks, but whether it should be dividend stocks or growth stocks is a question for another chart.

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