investor clinic

As interest rates fall, investors are dancing with dividend stocks again

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Dividend stocks were the wallflowers of the stock market for the past few years, as spiking interest rates and a sizzling tech sector caused investors to shower their affections elsewhere.

Now, dividend-paying companies are suddenly seeing an outpouring of love again.

With the Bank of Canada having lowered interest rates three times – including a quarter-point cut this week – and the U.S. Federal Reserve expected to kick off its easing cycle on Sept. 18, my model [Yield Hog Dividend Growth Portfolio](https://www.theglobeandmail.com/investing/investment-ideas/article-john-heinzls-model-dividend-growth-portfolio-as-of-aug-31-2024/) is finally emerging from its slumber.

From the end of June through the end of August, the [model portfolio](https://www.theglobeandmail.com/topics/yield-hog/) posted a total return of about 10.8 per cent. That compares with a gain of about 7.2 per cent for the S&P/TSX Composite Index over the same period. (All return figures cited here include dividends.)

The recovery in my portfolio, and dividend stocks generally, illustrates why investors need to exercise patience when certain sectors fall out of favour. Rather than selling out of frustration and locking in a low price, it usually pays to ride out the storm.

Dividends can play a key role in that regard. When a company sends you cash every quarter, or every month in some cases, it’s easier to resist the urge to do something you might later regret.

Some people call it “getting paid to wait.”

My model portfolio is a case in point. As of Aug. 30, the portfolio was valued at $166,017.66, representing a total return of about 66 per cent since Oct. 1, 2017, when I launched it with $100,000 of virtual cash. On an annualized basis, the portfolio has returned 7.6 per cent since inception.

While that still trails the S&P/TSX’s annualized return of about 9.3 per cent over the same period, the gap is narrowing. If short-term interest rates and longer-term bond yields continue to fall, as economists expect, dividend stocks could extend their gains.

What’s more, my [dividend](https://www.theglobeandmail.com/topics/dividend-investing/) income continues to grow, delivering on the portfolio’s primary goal to generate rising cash flow by investing in companies that steadily raise their payouts to shareholders.

The increase in income has been substantial. At inception, the portfolio was generating $4,094 of cash annually based on dividend rates at the time. Now, thanks to scores of dividend increases and regular reinvestments of cash to buy additional shares, the portfolio’s annual income has soared to $7,886 – an increase of roughly 93 per cent.

This includes recent dividend hikes from electricity producer Capital Power Corp. (CPX), which raised its payout by 6 per cent on July 30, and apartment owner Canadian Apartment Properties Real Estate Investment Trust (CAR.UN), which raised its distribution by 3.5 per cent on Aug. 15 – its first increase in three years.

And there is almost certainly more to come. Between now and the end of the year, I expect dividend increases from the utilities Fortis Inc. (FTS) and Emera Inc.

Now, I have some portfolio business to take care of.

In recent months, more than $1,200 of cash has accumulated in the model portfolio. Reinvesting dividends is critical for building wealth, as it puts the power of compounding on your side. Some investors enroll their stocks in a dividend reinvestment plan to make the process automatic, which is a great strategy. I prefer to manually reinvest my dividends, as it gives me more control over what I buy and when.

With that in mind, today I’m putting some of my cash to work.

Specifically, I’m adding 40 units of SmartCentres REIT

 (SRU.UN), for a total of 280 units. SmartCentres’ unit price was slammed by the COVID-19 pandemic and by the subsequent surge in inflation and interest rates, but the REIT has been rallying recently as interest rates ease and consumers rediscover their love for in-person shopping. (The purchase was completed at Tuesday’s closing price of $25.71, for a total cost of $1,028.40.)

As I wrote in a [recent column](https://www.theglobeandmail.com/investing/education/article-sell-smartcentres-depressed-units-now-that-wouldnt-be-smart/), SmartCentres – whose largest tenant by far is Walmart – has also been diversifying into other types of real estate, including condos and rental apartments, self-storage facilities, retirement residences and industrial properties. What’s more, the REIT also has an extensive bank of land for development opportunities, of which it can sell to raise cash.

Even after a roughly 17-per-cent gain in the unit price since the end of June, SmartCentres’ still yields more than 7 per cent, which is another reason I find the units attractive. As always, do your own due diligence before investing in any security, and make sure to maintain a diversified portfolio that suits your risk tolerance.

There’s no such thing as a sure thing in the stock market, but a portfolio that includes dividend stocks will likely benefit as interest rates continue to fall.