INVESTOR CLINIC

High rates are still hurting dividend stocks, but my cash flow keeps growing

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With the first half of 2024 in the books, today I’ll provide an update of my model dividend portfolio’s performance. I’ll also disclose how I’m investing the more than $2,000 of “cash” that has accumulated over the past few months.

To refresh people’s memories, I launched the model Yield Hog Dividend Growth Portfolio on Oct. 1, 2017, with $100,000 of virtual money. My goal was to identify companies with a track record of raising their dividends and a high probability of continuing to do so. (View the portfolio online at [tgam.ca/dividend-portfolio](http://tgam.ca/dividend-portfolio)).

Fast-forward to July 1, 2024, and the portfolio was valued at $149,900.39, for a total return, including dividends, of 49.9 per cent. On an annualized basis, that works out to a return of 6.2 per cent, compared with 8.4 per cent for the S&P/TSX Composite Index.

High interest rates continued to pose a headwind for dividend stocks in the first half, as the portfolio’s value slipped by about 0.9 per cent, lagging a gain of 6.1 per cent for the S&P/TSX, including dividends.

Compounding the general malaise about high rates, several companies in the portfolio struggled with their own issues. Toronto-Dominion Bank (TD), for instance, saw its stock price sink amid allegations about the bank’s lax anti-money laundering controls. And shares of BCE Inc. dropped on concerns about the company’s elevated debt levels and questions about the sustainability of its dividend.

Am I happy with the portfolio’s performance? No. Is there a silver lining? Yes. Even as the model portfolio has underperformed the index on a total return basis, its dividend income has grown substantially. At inception, the portfolio was generating $4,094 of cash annually, based on dividend rates at the time. Now, thanks to scores and divided increases and regular reinvestment of dividends, the portfolio’s annual income has grown to $7,590 – an increase of 85.4 per cent.

Barring some cataclysmic event, the portfolio’s income will only continue to grow. In the first six months of 2024, 10 of the 19 companies raised their payouts (there are also two exchange-traded funds, for a total of 21 securities). Most of the other companies will also likely hike their dividends in the second half.

All of that said, there’s no denying that a dividend-focused strategy has badly lagged the broader market over the past several years. The difference is especially stark when one looks south of the border at the S&P 500 index, which has benefited from huge gains in technology stocks. Since Oct. 1, 2017, the S&P 500 has posted a scorching annualized total return of about 14 per cent – more than double the return of the model dividend portfolio.

The lesson here is that, for all the benefits of a portfolio that generates high and growing income, investors need to diversify to capture the returns of other sectors. In my personal portfolio, for example, I supplement my core dividend holdings with a handful of exchange-traded funds that track the Canadian and U.S. markets. It’s a hybrid strategy that offers the best of both worlds: rising income and capital growth.

Speaking of income, it’s time to invest some of the cash in the model portfolio.

Today I’m announcing two purchases.

First, I’m acquiring 50 units of SmartCentres Real Estate Investment Trust (SRU.UN), bringing the model portfolio’s total holdings to 240 units. In a [recent column](https://www.theglobeandmail.com/investing/education/article-sell-smartcentres-depressed-units-now-that-wouldnt-be-smart/) I discussed several reasons why SmartCentres’ units are attractive at their current depressed levels. These include the REIT’s yield of more than 8 per cent, its improving financial condition and its extensive pipeline of development projects and portfolio of unused land. What’s more, demand for retail real estate is enjoying a pandemic-recovery rebound, which should provide a tailwind for SmartCentres. Should interest rates fall, that would almost certainly give the entire REIT sector an added boost.

For my second purchase, I’m adding 15 units of the U.S.-listed iShares Core Dividend Growth ETF (DGRO), increasing the model portfolio’s holdings to 155 units. DGRO holds more than 400 U.S. stocks with a track record of raising their dividends, including companies such as Procter & Gamble Co. (PG), Johnson & Johnson (JNJ), Coca-Cola Co. (KO) and McDonald’s Corp. (MCD). It also holds several big technology companies, including Microsoft Corp. (MSFT) and Apple Inc. (AAPL).

Together, these purchases – which were executed at Thursday’s prices – consumed about $2,300 of the portfolio’s $2,385 cash balance as of June 30. 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 and financial goals.