Finding Quality Dividend Growth Stocks

Magic Pants Dividend Growth Investing

We buy quality individual dividend growth stocks when they are sensibly priced and hold for the growing income.

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“Whether we’re talking about socks or stocks, I like buying quality merchandise when it is marked down.”

– Warren Buffett

Safety is not in the number of stocks you own but in the quality. In our three-step dividend growth investing process, looking for ‘quality’ companies is where we start. Without a quality company to invest in, not much else matters.

Quality Indicators

- Non-Cyclicals: To avoid having to time the market, we stay away from cyclical stocks.
- Growth Yield: Growth yield is the current annualized dividend divided by the original cost basis of the stock. In other words, growth yield is the yield you are now making, on dividends alone, from your original investment sometime in the past. We like to compare a historical growth yield and estimated future growth yield over ten-year periods. Assembling a portfolio of stocks with an average estimated growth yield greater than 7% is a good indicator that we have the right combination of starting yield and dividend growth.
- Dividend Growth Streak: We like to begin with a streak of at least ten years of dividend increases. The longer streak, the higher the quality.
- Dividend Growth Rates (5YR and 10YR): We are looking for consistent dividend increases. The lower the starting yield, the higher the growth rate and time horizon required to achieve our income goals.
- Payout Ratios (Dividends vs. Earnings) (Dividends vs Free Cash Flow): Low payout dividend payers have traditionally done better than companies with high or negative payout ratios. Figure out the industry average and measure against it.
- Recent Dividend Increase: A recent dividend increase is a positive statement by management that they have confidence in the business going forward.
- Dividend Growth and Price Growth Alignment: Finding companies whose historical dividend growth closely aligns with price growth makes forecasting future returns more predictable.
- Value Line’s Safety Rank: Measures the total risk of a stock relative to approximately 1,700 other stocks covered by Value Line. The safest stocks are assigned a rank of 1, whereas the riskiest ones are assigned a rank of 5.
- Value Line Financial Strength: Ratings, from A++ to C, in nine steps. Factors considered in assigning ratings include balance sheet strength, corporate performance, market capitalization, and stability of returns. The lowest rating is reserved for companies in serious financial difficulty.
- S&P Credit Ratings: Help investors determine investment risks. Ratings are either investment grade (AAA through BBB–) or speculative (BB+ through D)

Quality stocks benefit from strong business models and steady financial results over time. Their financial performance is, therefore, more consistent and predictable from one period to the next. When building investment strategies focused on quality stocks, this historically translates into steady, robust returns in a large array of market scenarios.

A company we invest in rarely satisfies all of our criteria but the more ‘indicators’ we check off, the higher the quality of the business. To learn how to apply our quality indicators and start using our process, which has easily outperformed all major Canadian dividend ETFs and Mutual Funds over the last decade, all you have to do is subscribe below.