

Focus on quality, not just high dividend yields

Investment Strategy Team



Many investors wisely look to dividend-paying stocks as a complement to other income-producing investments in their portfolios, such as fixed-income investments. However, in their search, some investors are focusing on the highest-yielding stocks. Higher yield is usually associated with higher risk, and these stocks may fall short of expectations.

To help protect your dividend income, we recommend owning higher-quality stocks that have the potential to grow their dividends over time, with a focus on portfolio diversification. Quality companies with strong balance sheets are generally the ones most able to sustain their dividends in tough times and increase their dividends over the long term.



What is yield?

The dollar amount of dividends paid in a year relative to the share price. The dividend yield is expressed as a percentage.

High-yield stocks typically carry higher risk

In their search for dividend income, some investors are focusing on the highest-yielding stocks. Higher yield is usually associated with higher risk, and these stocks may fall short of expectations. High yields can be the market's signal that investors have concerns. If the market is pricing a stock at a level where the yield is unusually high, it may be signaling one or more of the following:

- The dividend is increasingly at risk and could be cut.
- Growth prospects or business fundamentals at the company have deteriorated, and future dividend increases are unlikely.
- The level of income isn't quite what it appears to be. With certain types of investments (such as master limited partnerships), some of the income ends up reducing your cost basis and may potentially result in your having to pay more taxes when you sell the stock.

Additionally, higher-yielding stocks can be sensitive to interest rates. For example, in periods when interest rates are rising, the prices of high-yield stocks could face pressure, potentially declining as bonds become more attractive and the cost of debt rises. While higher dividend-yielding stocks may be appropriate as part of a diversified portfolio, this should not be the only factor to consider when making investment decisions.

Rising income and total return matter

It's important to focus on your total return from owning stocks and the potential for rising income, not just current dividend income. Total return includes share price appreciation and dividend income over time. In addition, a primary reason for owning dividend-paying stocks is the opportunity for rising income, whether reinvested or used to pay for everyday living.

Balancing yield with quality

Companies that pay and grow their dividends over time are typically of higher quality. Higher-quality companies historically offer benefits including:

- **Reliable income** — Companies with excess cash flows and strong balance sheets often choose to pay dividends to attract and reward their shareholders, and are generally the most able to sustain their dividends in tough times and increase their dividends over the long term.
- **Rising income potential to help offset inflation** — Inflation reduces how much you can buy, because the cost of goods and services rises over time. However, higher-quality stocks that increase their dividends on a regular basis give you a rising income stream to help balance the higher costs of living over time and protect your purchasing power.

- **Total return potential** — If you reinvest your dividends into additional shares of stock, your money has the potential to grow faster, helping you benefit from the power of compounding. Historically, dividend payments have been an important part of the total return from stocks. Over the past 20 years, dividends that have been reinvested have accounted for nearly 20% of the total return on stocks over the long term.*
- **Quarterly or monthly income** — Consider using dividend-paying stocks with longer track records to supplement other sources of income, such as the fixed-income investments in your portfolio or from sources outside your portfolio. While most companies pay dividends quarterly, if you're using this money as a more regular income stream, consider staggering the dividend payment dates of your stocks.

And since dividends can be increased, decreased or eliminated at any point without notice, maintaining a well-diversified portfolio of stocks can help you manage the impact of any individual company's decisions regarding their dividend payments.

*Source: Morningstar, Edward Jones, 12/31/2024.

Edward Jones can help

Your financial advisor — backed by a broader team of Edward Jones investment professionals creating our stock portfolio guidance, alongside research from our trusted resources, CFRA and Morningstar — can help you determine the most appropriate combination of dividend-paying stocks for your portfolio.

Investing in equities involves risk, the value of your shares will fluctuate, and you may lose some or all of your principal.

This content is intended as educational only and should not be interpreted as specific recommendations or investment advice. Investors should make investment decisions based on their unique investment objectives and financial situation.