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Investors Have Put $43 Billion in Dividend-Paying Funds This Year. Before You 'Chase Dividends,' Here's What to Know

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Investors Have Put $43 Billion in Dividend-Paying Funds This Year. Before You 'Chase Dividends,' Here's What to Know

- With increased fears of a possible recession, investors seeking steady income may turn to stocks paying quarterly dividends.
- While dividends may be appealing during a flat or down market, it's important to assess the company before buying.
- "People sometimes chase dividends, and they don't understand the risks," said Scott Bishop, executive director of wealth solutions at Avidian Wealth Solutions in Houston.

With increased fears of a possible recession, investors seeking steady income may turn to stocks paying quarterly dividends, which are part of company profits sent back to investors.

Historically, dividends have significantly contributed to an asset's total return, sometimes providing a boost during economic downturns.

From 1973 to 2021, companies paying dividends earned a 9.6% total annual return, on average, beating 8.2% from the S&P 500 Index, and eclipsing the 4.79% yield from non-dividend payers, according to a 2022 Hartford Funds study.

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Dividends have investors' attention: Dividend funds have added $43 billion in 2022 as of late June, according to SPDR Americas research.

Still, investors need to scrutinize their picks before adding dividend payers into their portfolios.

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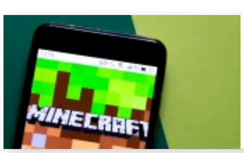

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"People sometimes chase dividends, and they don't understand the risks," said certified financial planner Scott Bishop, executive director of wealth solutions at Avidian Wealth Solutions in Houston.

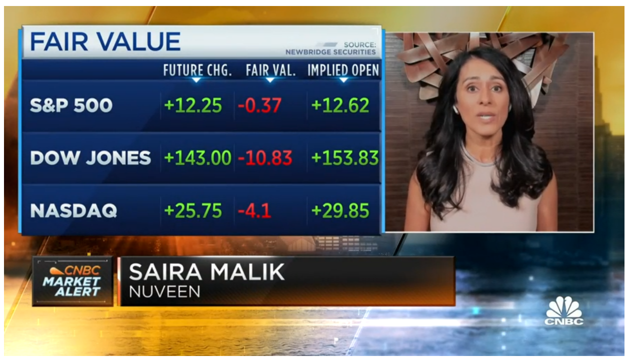
Here's what to know.

Why dividends are attractive in tough economic times

"Dividend-paying companies are typically going to have higher levels of free cash flow," said Dave Sekera, chief U.S. market strategist at Morningstar. And they may be valued more modestly, he said.

"Both of those have definitely been attractive for investors this year as we see the economy softening, interest rates rising and inflation still running hot," Sekera said.

Dividend payers tend to be large, mature companies, producing products and services still needed during a recession, explained Kashif Ahmed, a CFP and president at American Private Wealth in Bedford, Massachusetts.



"Nobody needs a Rolex every day, but we all need toilet paper," he said.

Some companies, known as the "dividend aristocrats," have a history of increasing dividends annually, even during previous recessions. And many companies are slow to cut dividends, providing some investors with reliable cash flow.

Be critical when chasing high dividend yields

While a higher dividend payout may be appealing during a flat or down market, it's important to assess what you're buying before adding new assets to your portfolio. As Bishop pointed out, there can be risks.

There are two parts to a company's dividend yield: the annual dividend per share and the current share price, Bishop explained. If the dividend yield is far above similar companies, the stock price may have dropped for various reasons.

"You shouldn't just look at dividend yield," Bishop said, explaining why it's essential to understand the financials of the company.

And for those unwilling to analyze each company, dividend-paying funds may offer more diversification than individual stocks.

Keep dividend payers in tax-friendly accounts

Single filers

0%	$0 to $41,675
15%	$41,676 to $459,750
20%	$459,751 or more
Married filing jointly	

Whether you receive income from stocks or bonds, you'll need to be strategic with what kind of account you use to hold those assets, Ahmed explained, especially if you're an investor in a higher tax bracket.

Generally, it's better to keep income-producing assets, such as dividend-paying stocks, mutual funds with annual payouts or bond coupons, in tax-friendly accounts, like a 401(k) or individual retirement account, he said. Otherwise, you may owe yearly taxes on capital gains.