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Market Spotlight

Creating income from Canadian dividends and the new era of bond investing

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Creating an investment income with Canadian dividends

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All too often investors limit themselves to fixed income investments such as bonds when looking to create a regular income stream. But, did you know, Canadian dividends can also be used as an income source within an investment portfolio?

When a company makes a profit, it can choose to retain the profit or distribute a portion of it to its shareholders. These payouts, typically made quarterly or annually, are dividends.

Investing in profitable Canadian companies that pay a dividend to shareholders can be a tax-efficient way to create a regular investment income stream from your portfolio over the long-term. Here are three benefits to choosing Canadian dividends to help create income within your investment portfolio:

Dividends have preferred tax treatment

Canadian companies that pay eligible dividends offer investors an attractive way to generate investment income because dividends receive preferential tax treatment versus income from interest-bearing investments. Interest income from investments such as high interest savings accounts (HISAs) and guaranteed investment certificates (GICs) is taxed at your marginal tax rate. This can be attractive for investors who are looking to generate an income stream within their non-registered investment accounts. We offer several dividend investment solutions such as the CIBC Dividend Income Fund and the CIBC Dividend Growth Fund.

Dividend payouts can increase over time

Canadian companies have a strong history of growing their dividends over the long term which helps investors grow their investment portfolio. When a company turns a profit, that profit can be paid out to shareholders in the form of a dividend. The more a company grows, the higher the potential dividend an investor could receive. Investors in many Canadian companies are already benefiting from the recent outperformance of dividend-heavy sectors such as telecommunications, utilities and financials. As of November 25, 2024, Canadian banks and insurance companies have 5-year dividend growth rates of 7% and 9% respectively. Telecommunication companies have 5-year dividend growth rates of approximately 5%.

Canadian dividends can help diversify an equity portfolio

High quality, mature dividend paying companies tend to have low correlations with growth stocks in sectors like information technology. They also tend to have lower volatility and better downside protection during market corrections. This provides investors with a smoother return profile over time.

If you're looking to create a regular investment income stream, you may naturally think about investing in fixed income—which provides a fixed rate for a fixed time horizon. However, if you're looking to grow your investment income over the long term, Canadian dividends can be an attractive solution.

Strategies to help you invest in the new era of fixed income

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Since the start of the central bank rate hiking cycle in 2022, many fixed income investors have been focused on capturing the high yields available in such ultra-short-term investments as guaranteed investment certificates (GICs). However, with many central banks around the world lowering interest rates, the forces that made these investments so attractive are waning.

Almost as soon as the Bank of Canada (BoC) started cutting its overnight rate in June, short-term bond yields started dropping more than longer term yields. In other words, the days of short-term interest rates being higher than longer-term rates have disappeared. In turn, investors are looking for new ways to earn attractive interest rates and total returns. There are two key strategies investors can explore to help maximize fixed income returns:

Think about target maturity fixed income investments

Investing for a longer period of time usually offers a higher rate of return. So instead of investing in an asset that matures one year from now, consider investing in a bond fund with a target maturity of 3 or 5 years. In addition to offering yields that are still at historically high levels, you avoid the risk of reinvesting in a lower yielding one-year bond fund a year from now. Extending can be done by investing in target maturity funds that have longer term target maturity dates and by laddering target date funds across different maturity dates.

Use traditional bond funds to grow and preserve capital

While short-term investments will always have their place in a balanced portfolio, taking a long term view (+10 years) to fixed income investing with an actively managed bond fund has its advantages. Doing so can provide a strong income baseline and attractive upside potential at lower risk levels when compared to equities and other riskier asset classes.

We can demonstrate this by comparing the yield on a 1 year Government of Canada bond to the yield on a longer-term bond fund. As of October 31, 2024, a 1 year Government of Canada bond was yielding 3.09% whereas the yield on the CIBC Canadian Bond Fund was 4.32%. An active bond fund manager has the flexibility to build a fund with multiple yields and maturity dates to help take advantage of liquidity as well as higher interest rates from longer dated bonds.

With yields falling, income investors may want to consider the higher yields available in longer-term traditional or target maturity bond funds. Doing so can help compound returns over longer time horizons with potential lower volatility than higher risk equity investments. Opportunities in fixed income investing are alive and well, and these strategies lend themselves to the possibility of more optimal returns.

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Contact us any time

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