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Dividend investing works: Here's five years of proof

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Wednesday is the fifth anniversary of Strategy Lab (cue sound of Champagne corks popping), and to mark the occasion, I'll be taking a detailed look at how my model dividend portfolio has performed.

The numbers make it clear: Dividend investing works. Even I was pleasantly surprised by some of the data – particularly by how much my dividend income has grown.

More in that in a moment. First, a quick recap of my investing philosophy.

When Strategy Lab launched in September, 2012, my goal was to choose blue-chip companies that raise their dividends regularly. As I wrote at the time: "Being a conservative fellow, I selected companies that would provide – fingers crossed – very few nasty surprises." Thankfully, I've managed to avoid any blowups.

In keeping with my buy-and-hold approach, I also vowed to do very little trading apart from reinvesting my dividends regularly. I've largely stuck to that promise, having sold just two of the original 12 securities. (I replaced Coca-Cola Co. and McDonald's Corp. with Johnson & Johnson and Brookfield Infrastructure Partners.)

So, how did the portfolio do? Well, as of Sept. 12, it was worth $86,596 – an increase of 73.2 per cent from its initial value of $50,000. On an annualized basis, that works out to a total return of 11.6 per cent – easily topping the S&P/TSX composite index's annualized total return of about 7.2 per cent over the same period. (All returns include dividends.)

Sadly, the "money" in Strategy Lab isn't real. But I employ the same dividend-growth approach in my personal portfolio and have achieved very similar results.

Now, let's look at how much income the model portfolio has generated and how the cash flow has grown over the last five years. Here are a few highlights:

Yup, 71 times. Specifically, I received 10 increases each from Royal Bank of Canada and Telus Corp., nine from Bank of Montreal, six from Enbridge Inc. and five each from TransCanada Corp., BCE Inc., Canadian Utilities Ltd., Procter & Gamble Co. and Fortis Inc. Brookfield Infrastructure and J&J, which were added to the portfolio in 2015, contributed three increases each, while McDonald's and Coca-Cola raised their dividends a total of five times before I sold them.

All those dividend hikes – combined with dividend reinvestments and, in the case of my U.S. stocks, a falling Canadian dollar – gave my portfolio's income a huge boost. At inception, it was generating annual cash flow of $1,876. Based on dividend rates today, the portfolio's annual income has climbed to $3,384 – an increase of 80 per cent. And I fully expect the income will continue to grow in the years ahead.

This underlines one of the key benefits of the strategy: It generates a rising income that increases your purchasing power and protects you from inflation. For retirees and others who want to supplement their cash flow, dividend growth stocks can be an excellent choice.

Did everything go right for my portfolio? Of course not. My one exchange-traded fund, the iShares S&P/TSX Capped REIT Index ETF, is trading below the price at which I bought it. On a happier note, the ETF's monthly distribution has grown by about 14 per cent.

Another stock that has posted underwhelming returns – particularly in recent years – is pipeline operator Enbridge. Even as the company has pledged to increase its dividend at a rate of 10 per cent to 12 per cent through 2024, investors are concerned that Enbridge's long-term earnings growth could be crimped if oil prices remain at depressed levels.

Those disappointments aside, I've been largely satisfied with the portfolio's performance. As I expected when Strategy Lab started, choosing blue-chip stocks with growing dividends has generated a nice combination of capital gains and rising income.

"Dividend investing suits my personality," I wrote in my first Strategy Lab column. "The frequent cash payments satisfy my desire for instant gratification, and the gradual dividend increases and stock price gains reinforce the principle that investing is a long-term game, not a contest to see who can make the most amount of money in the shortest period of time."

Five years later, my dividend growth strategy has played out almost exactly as I had expected. And, based on the feedback I have received from readers, I know I'm not the only one profiting from the dividend growth approach.

References

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