THE GLOBE AND MAIL

Why it isn’t time to dump your dividend stocks in fear of a correction

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The Globe and Mail
Published Friday, Mar. 24, 2017 1:44PM EDT
Last updated Saturday, Mar. 25, 2017 3:47PM EDT

A couple nearing retirement has about $800,000 in dividend stocks. Should they sell to avoid the stock market correction they fear?

In a recent edition of my e-mail newsletter, Carrick on Money, I suggested they hold on rather than try to time a move to sell their stocks and then re-purchase them at a later day. A reader of the newsletter disagrees. “Wasn't impressed with your answer to today's couple wanting to know if they should sell their dividend stocks anticipating a market correction,” this person wrote. “You recommended the tired old buy and hold forever strategy. This is just as bad as buying high and selling low.”
This reader’s preferred approach: Sell stocks when they reach a pre-set return, say 10, 20 or 30 per cent. Then, buy them back when the price has fallen and the dividend yield has risen (yields rise when prices fall). This person sees a dividend yield of 4 to 6 per cent as a buy signal.

Well, sure. This approach could work for a disciplined, experienced investor who has the time and inclination to micro-manage a portfolio of stocks over a long time horizon. Does that fit the profile of the retired couple with the $800,000 portfolio of dividend paying bank, utility and telecom stocks? Maybe. But on the chance it doesn’t, the buy and hold approach still seems prudent.

Timing moves in and out of the market generates trading commissions for brokerage firms – this we know for certain. But most investors will stumble in picking the right points to sell and then re-purchase. Even if they have strict guidelines to follow, emotions can confuse things. This presents the risk of selling in the worst of a correction and then buying back once stocks have already climbed a lot.

And then there’s the matter of what to do with the cash generated from selling stocks. I discussed cash parking spots in this recent column – the returns are typically in the 0.75 per cent range. That’s quite a comedown from the yields produced by the sort of dividend stocks our retired couple holds. It’s important to note that unless the economy craters, it’s highly unlikely for the flow of dividends from bank, utility and telecom stocks to be interrupted in a stock market correction.
To sum up, trying to deke around a correction by selling and then re-purchasing dividend stocks can hurt you in two ways – you lose out on dividends while you’re holding cash, and you run the risk of vaporizing wealth by mis-timing sell and buy transactions.

Buy and hold sounds old, but it works if you own quality investments like blue chip dividend stocks.