Kiplinger's PERSONAL FINANCE

Why You Should Invest in Dividend Stocks

Plus, what to look for when you do.

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In good times and bad, and especially in uncertain times, a wise investor looks past the hustle and hype and goes for consistency. A thoughtful long-term dividend strategy can provide that for your portfolio – and it's a particularly appealing approach in today's low-interest-rate environment.

The benefits of dividends are well-documented. Past performance doesn't indicate future results, but since 1960, 29% of Standard & Poor's 500-stock index's returns have come from dividends. They're known to provide a cushion against the scary ups and downs of the market, with lower volatility and a higher Sharpe ratio (risk vs return). And dividend payers tend to outperform non-dividend payers over the long run.

There are considerable tax benefits, as well. Qualified dividends are taxed as capital gains, often at a lower tax rate than interest and income tax. When it comes to legacy planning, inherited stocks can be passed on to your heirs at their current value, otherwise known as a step-up in basis. This potentially allows the estate to bypass paying capital gains on these holdings, leaving more money behind where you want it – with your children or other specified beneficiaries.

A dividend strategy may seem a slow, perhaps even boring, way to invest. You won't see the crazy-high yields some stocks offer – but you likely won't experience the gut-punch lows, either. If you do your homework and choose well, that is.

Here are some things to take into consideration when deciding which dividend-paying companies you should invest in.

Don't chase yield. A lot of people chase dividends. After all, you're in this to make money, right? But sometimes companies declare dividends to grab investor interest and boost share price. That burst of benevolence doesn't necessarily mean it's a strong company or a good long-term purchase. Do your research: Can the company afford to continue paying dividends? If it can't, beware – there may be a dividend cut in your future. And the market has been known to punish companies for inconsistency.

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Look for long-term stability. Focus on the underlying strength of the business in which you are investing, not day-to-day or even year-to-year fluctuations. A mature company that has been delivering reliable dividends every year for decades isn't likely to stop. It's going to work very hard to maintain its reputation and not disappoint investors.

Target companies that increase their dividends over time. Companies that increase dividends consistently dominate their industry. They tend to be more stable. They usually outperform the market; and when the market is down, they out-perform the market even more. They have strong fundamentals, steady income streams and consistent earnings. And those reliable dividends are a good sign that management is looking out for shareholders. (These stocks aren't inexpensive, of course. But they deliver the goods year after year, often for generations of investors.)

Watch out for overvalued stocks. A lot of people are looking at dividend stocks right now because other yields are so low. The problem is that, when something is hot, it can become overvalued. Don't fall into the trap of looking only for a high-dividend payer. On the flip side, even consistent dividend payers can develop problems that can make them less profitable.

As with any financial strategy, education, balance and discipline are the keys when investing in dividend stocks. Do your homework – and if you need help, a good financial professional will be happy to answer your questions.

Kurt and his team at Wealth Trac Financial can guide you through major financial decisions. Call 888-519-9614 to learn more.