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If interest rates start to fall this week, it’s go-time for dividend stocks

ROB CARRICK || JUNE 3, 2024

It’s easy to justify hanging onto a cash equivalent investment product when you’re getting virtually risk-free returns of almost 5 per cent or more.

But if the Bank of Canada starts cutting its overnight rate Wednesday, returns from the hugely popular category of exchange-traded funds holding money in savings accounts, treasury bills and short-term corporate borrowings will edge lower. An alternative to consider if you’re moving money out of these products? Dividend stocks and ETFs.

“As rates go lower, that’s when you’re going to see dividend ETFs and dividend companies come back,” said Naseem Husain, senior vice-president and ETF strategist at Global X, formerly Horizons ETFs. “There are going to be more nuanced conversations.”

You can get yields as high as 6 per cent to 8 per cent from some blue-chip stocks right now. Yet billions of dollars are sitting in low-risk cash equivalent ETF products paying almost 5 per cent.

Some dividend stocks have participated fully in the stock market rally of the past while, but a raft of stalwart names have remained in the penalty box. While the S&P/TSX Composite Index was up 6.5 per cent for the year through May on a total return basis, the S&P/TSX Canadian Dividend Aristocrats Index was up 1.9 per cent. Among the stocks in this index are Enbridge Inc. (ENB-T), TC Energy Corp. (TRP-T -0.50%decrease) and Bank of Nova Scotia (BNS-T -1.41%decrease), each with an elevated yield of 6 per cent to 7 per cent. High yields are driven by falling share prices.

Bonds are another buy-low option for money in cash equivalent ETFs right now. The FTSE Canada Universe Bond Index was down about 2 per cent for the year through May and lost money in two of the previous three years. But Mr. Husain said dividend stocks and ETFs offer more upside than bonds right now.

Think total return here – plus-size dividend yields on top of share price gains. A possible taste of what’s ahead when rates fall: TC Energy gained 6.6 per cent in May, while decidedly out of favour BCE Inc. (BCE-T) gained 3 per cent.

A sustained turnaround for dividend stocks will take time. While the majority view is that the Bank of Canada will start the process of rate cutting with a drop of 0.25 percentage points in the overnight rate Wednesday, some observers see the bank waiting until July 24. After that, there are three more opportunities this year for the central bank to cut rates and, indirectly, create a more favourable environment for hard-hit dividend stocks.