Growth vs Dividend Stocks

Matching Companies to Your Goals — Lesson Explainer

The Concept

Once a company generates free cash flow, it can reinvest it (growth stocks - little/no dividend, valued on future growth) or return it directly to shareholders (dividend stocks - typically mature, stable businesses).

Dividend yield = annual dividend per share / share price. Payout ratio = dividend per share / EPS - a low payout ratio means room to grow the dividend; near or above 100% means it may not be sustainable.

Total return = price appreciation + dividends received. Comparing only price performance between growth and dividend stocks misses half of a dividend stock's actual return.

Illustrative Example: Growth Co vs Dividend Co, One Year

Metric	Growth Co	Dividend Co
Starting Share Price	$100.00	$100.00
Ending Share Price	$122.00	$106.00
Dividends Paid That Year	$0.00	$4.00
Price Return	+22.0%	+6.0%
Dividend Yield	0.0%	4.0%
Total Return	**+22.0%**	**+10.0%**
Payout Ratio	0%	60%

Growth Co delivered a higher total return this year - but that alone doesn't settle which is 'better'. Dividend Co's return came with more stability and cash along the way. Both are legitimate strategies depending on goals.

5 Things to Know About Growth vs Dividend Stocks

1. Total return includes dividends, not just price - comparing only price understates dividend stocks.

2. A payout ratio near or above 100% is a sustainability flag.

3. Growth stocks are valued on the future, dividend stocks more on the present.

4. Neither category is inherently safer - dividends can be cut, growth valuations can reset.

5. This isn't strictly binary - many companies sit in between.

4 Things to Check Before Choosing Either Style

- Know your own goal - income now vs growth later.
- Check the payout ratio - little cushion if it's near/above 100%.
- Look at total return, not just yield.
- Match to your time horizon - growth needs a longer runway.

Worth knowing:
neither growth nor dividend investing is universally 'better' - they suit different goals and time horizons. Diversifying across both styles is common practice, not an admission of indecision.

Quiz — Answer the questions, then check the key on the next page

1. What does total return include that a plain price chart misses?

A. Nothing, they're the same thing
B. The company's revenue growth rate
C. Dividends received along the way
D. The company's employee headcount

2. What does a payout ratio near or above 100% suggest?

A. The company has no dividend at all
B. The stock is definitely a good buy
C. The company's revenue is growing rapidly
D. The dividend may not be sustainable if earnings dip

3. Why are growth stocks generally more sensitive to changes in growth expectations?

A. They pay the highest dividends of any stock category
B. They're valued mainly on future earnings, so price reacts sharply to outlook changes
C. They never report earnings
D. Growth stocks are immune to market swings

4. Why is neither growth nor dividend investing inherently 'safer'?

A. A 'safe' dividend can be cut, and a growth stock's valuation can reset - both carry risk
B. Dividend stocks can never lose value
C. Growth stocks are guaranteed to outperform over any period
D. Risk only applies to growth stocks

5. Why doesn't Growth Co's higher total return automatically make it the 'better' pick?

A. Because Growth Co's numbers were fabricated
B. Because Dividend Co technically returned more money
C. Because which is 'better' depends on the investor's goals and time horizon
D. Because total return doesn't apply to growth stocks

Answer Key

1. What does total return include that a plain price chart misses?

Correct answer: C. Dividends received along the way

Total return = price appreciation plus dividends - comparing only price understates dividend stocks.

2. What does a payout ratio near or above 100% suggest?

Correct answer: D. The dividend may not be sustainable if earnings dip

Most or all earnings are being paid out, leaving little cushion for a bad year.

3. Why are growth stocks generally more sensitive to changes in growth expectations?

Correct answer: B. They're valued mainly on future earnings, so price reacts sharply to outlook changes

Any shift in how investors see a growth stock's future tends to move the price more sharply.

4. Why is neither growth nor dividend investing inherently 'safer'?

Correct answer: A. A 'safe' dividend can be cut, and a growth stock's valuation can reset - both carry risk

Both styles carry real, different risks.

5. Why doesn't Growth Co's higher total return automatically make it the 'better' pick?

Correct answer: C. Because which is 'better' depends on the investor's goals and time horizon

One year's result doesn't settle which strategy fits an investor best.