Common Stock Yields

The common stock yield is the dividend per share divided by the share price. It tells you the percentage return you'll get each year in dividends based on the current stock price. Yields matter to stock investors because dividends provide regular income on top of any share price appreciation. Stocks with high yields can look attractive, especially if you want income. However, high yields might mean the share price dropped, causing the yield to artificially rise.

Example

The common stock of XYZ Inc. currently pays an annual dividend of $0.50 per share. With the stock price presently at $15 per share, this represents a dividend yield of 3.33% for investors. This yield is calculated by taking the $0.50 dividend payment and dividing it by the $15 share price, which equals 0.033 or 3.33%. In other words, an investor who purchases a share of XYZ Inc. stock at the $15 market price will receive annual dividend payments amounting to about 3.33% of the capital they invested, which works out to $0.033 in dividends for every $1 used to buy the stock. This dividend yield provides a sense of the regular income investors can expect to gain in return for holding shares of XYZ Inc (Lee, 2022).

If a company suspends dividend payments, as a shareholder you don't have much power. You can vote to replace board members or sell your shares, but you can't legally force the company to pay dividends. The board controls dividend policy.

Bond Yields

A bond yield is the annual interest payment as a percentage of the bond price. It defines the fixed return you'll earn by holding the bond to maturity. Bond yields are a key return measure for bond investors. Higher yields mean more income.

But high yields can signal higher risk too, like worries about inflation or default. As risk seems higher, bond yields tend to rise. The tradeoff is yield versus safety. Still, bond yields guarantee a known return, unlike fluctuating stock dividends.

If interest payments stop, bondholders have more options than stock investors. Missed payments mean default. Bondholders can take legal action to get their principal back early or obtain other remedies. Bondholders get paid before stockholders in bankruptcy too.

Example

If an investor purchases a bond with a face value of $1,000 at par, meaning for $1,000, and the bond pays annual interest of $45, the coupon yield would be 4.5% ($45 divided by $1,000). However, if the bond price subsequently rises to $1,030, the current yield would fall to 4.37% ($45 divided by $1,030) to reflect the new higher price. This current yield matters more if selling the bond before maturity, while the original coupon yield of 4.5% represents the annual interest income an investor would receive by holding the bond all the way through maturity. So for a buy-and-hold strategy, an investor buying at par could expect to realize the same 4.5% yield as represented by the coupon rate (Understanding Bond Yield and Return, 2022).

The Bottom Line

The core difference is bonds offer fixed yields and legal protections. Stocks provide variable dividends without guarantees. Weighing yields helps decide your investing goals - growth from stocks or stability from bonds.

References

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