What’s Happened to Defensive Stocks?

Description

As investors are aware, there are numerous securities to choose from when making an investment. One way to categorize securities is either as defensive or cyclical.

For those not in the know, defensive companies are characterized by minor fluctuations in revenues and earnings during both good and bad economic cycles. Cyclical companies on the other hand are characterized by above average fluctuations in revenues and earnings.

For investors with many years of experience, the risk/reward relationship of investing in a defensive company instead of a cyclical company may be better understood. Although cyclical investments have the opportunity for higher growth in profits after a recession, the opposite is also true when going into a recession.

What’s going on with defensive stocks?

Looking at a number of defensive securities, the returns over the past year have been fantastic. A key reason for purchasing defensive companies is for the sustainability of the dividend yield. While the growth in yield may be less for defensive securities when compared to cyclical securities, the likelihood of regular increases is much higher.

The challenge investors face after achieving returns is finding new undervalued securities to purchase in the hopes of attaining similar returns.

Considering **North West Company Inc** (TSX:NWC), the company is in the business of running grocery stores in remote regions in Northern Canada and Alaska. The stock traded under $25 in November of 2016, and shares have risen to almost $32 as of late. Investors having bought at a price of $25 received a dividend yield on their money close to 5% while current investors are receiving no more than 4%. What was an attractive 5% yield has become a reasonable 4% yield with very little potential for capital appreciation. Instead, investors now carry downside risk should shares decrease in value.

Another company called **Pure Industrial Real Estate Trust** (TSX:AAR.UN) which operates in the industrial real estate sector has experienced a price return of almost 35% over the past year while offering investors a current yield close to 4.75%. What traded at a discount to tangible book value 52 weeks ago is now trading at a 19% premium. The bad news for investors looking to make a purchase is the dividend yield has declined as the shares have risen in value. The 52-week low was $4.81 which would have translated to a dividend yield of 6.48%.

Where is the opportunity?

Looking for defensive companies with the potential for dividend growth and capital appreciation is a tall order. Presently, shares of **Empire Company Limited** (TSX:EMP.A) offer investors a dividend yield close to 2% and the potential for increases in both capital appreciation and dividends. The company which has a large footprint in western Canada has started to turn the corner with a rebound in the oil sands and, with a new CEO at the helm, may just be about to breakout once again.

Investors looking for long term dividend growth may want to stick with the defensive companies over the cyclical names.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. TSX:EMP.A (Empire Company Limited)
2. TSX:NWC (The North West Company Inc.)

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