Should You Avoid These 2 Top Dividend Stocks as the Loonie Rises?

Description

The strengthening Canadian economy and the Bank of Canada's interest rate hikes have pushed the Canadian dollar to the highest point since 2015.

This sudden and unexpected jump in the value of the currency has some implications for dividend-paying companies which have a major portion of their revenue priced in the U.S. dollar.

Let's analyze if **Canadian National Railway Company** (TSX:CNR)(NYSE:CNI) and **Algonquin Power & Utilities Corp.** (TSX:AQN)(NYSE:AQN) will be affected by the strengthening dollar and rising interest rates.

CN Rail

CN Rail stock has soared more than 11% so far this year, massively beating the benchmark stock index. This stellar performance is backed by healthy second-quarter results in July, when the company reported that its adjusted net income rose by 17% and revenues surged to a record high.

There is no doubt that CN Rail is greatly positioned to benefit from a robust economic activity in North America due to its coast-to-coast rail network, which is a backbone for the cross-border trade.

But a rising Canadian dollar poses a threat to its bottom line, because a large portion of its revenues and expenses is denominated in U.S. dollars.

According to CN Rail, about 17% of its sales were linked to U.S. domestic traffic last year, and an additional 34% involved trans-border traffic. Due to this large exposure to the U.S. dollar, CN Rail estimates that every one-cent change in the Canadian dollar would affect net income by approximately $30 million.

“The North American economic outlook continues to be positive, and we remain committed to delivering on our 2017 financial outlook,” said Luc Jobin, president and chief executive officer, in earning statement. “However, volume comparisons in the second half of the year will be more challenging, and the strengthening of the Canadian dollar will constitute a headwind.”

Algonquin Power & Utilities Corp.

The Ontario-based Algonquin Power is a North American diversified generation, transmission, and distribution utility with $10 billion of total assets.

Over the past three months, Algonquin stock has fallen about 5%, hurt by rising interest rates, which reduce the investment appeal of utilities when compared to the risk-free assets, such as government bonds and GICs.

A stronger Canadian dollar also hurts the company because Algonquin declares its dividends in U.S. dollars, which means less income for those who need to convert their income back into the local currency.

Which stock you should avoid?

Both CN Rail and Algonquin Power are solid dividend stocks offering 1.64% and 4.41% yields, respectively, on current prices.

In the case of Algonquin Power, the dividend yield is very attractive and provides a good diversification opportunity to investors. The company gets about 70% of earnings from regulated utilities and 30% from contracted renewable power.

The company plans to increase its dividend payout by 10% each year for the next five years as its undertakes its $6.3 billion capital-deployment plan.

Similarly, CN Rail is a great growth and dividend stock which should be a part of any diversified income portfolio.

I don’t think dividend investors in these stocks should panic due to the changing economic picture. For long-term investors, any weakness in these two stocks is a buying opportunity.

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