Railway Stocks Plunge on U.S. NAFTA Pullout Fears: Buy the Dip?

Description

The entire railway sector sold off on Wednesday following reports that Canada is convinced that President Trump will pull out of NAFTA as early as this month. The deterioration of NAFTA is a huge potential negative for the Canadian rail stocks in particular, which sold off more violently than their American counterparts. **Canadian National Railway Company** (TSX:CNR)(NYSE:CNI) and **Canadian Pacific Railway Limited** (TSX:CP)(NYSE:CP) both plunged by 2.71% and 3.14%, respectively, as the negative momentum picked up in the latter part of the trading day.

Approximately ~30% of railway revenues involve movement across the border, so the impact is a huge worry for shareholders of two of Canada's most prized wide-moat businesses.

Douglas Porter, chief economist at **Bank of Montreal**, believes that the impact caused by such a U.S. NAFTA pullout would be serious but manageable.

The Canadian dollar, which has been picking up positive momentum lately, took a step back on Wednesday on worries surrounding NAFTA. BMO released a study stating that the loonie would likely depreciate in value by ~5% in response to a ~1% decrease in Canada's GDP. Such a depreciation would allow Canada to become more competitive on the export front, even if tariffs are raised by a considerable amount.

Should you buy the rails on the dip?

While NAFTA-related risks are something to be concerned about, I think investor fears are mounting and may begin to become overblown. I believe these fears will create a terrific entry point for long-term investors looking to bolster their portfolios with extremely wide-moat dividend-growth kings.

While everyone's focused on NAFTA, the general public may not be realizing the tailwinds that the rails are likely to enjoy over the short to medium term. CN Rail has been aggressively hiring and buying more locomotives to prepare for a volume surge, which I believe will send rail stocks much higher, regardless of potential tariff hikes on cross-border trade.

In addition, U.S. tax reform is going to be a major positive for both Canadian rails as the tax rate decreases from 35% to 21%, so it's not all bad news for the Canadian railways this year.

Which is the better Canadian railway to buy today?

I believe CN Rail is the much better choice today because of its innovative new tech, which could revolutionize the way heavy crude is transported across long distances. Although CP Rail is slated to benefit from a surge in crude by rail, I believe CN Rail could potentially be the pioneer in the crude-by-rail 2.0 movement, as it attempts to steal glory away from the pipelines.

Bottom line

NAFTA fears are mounting, and trade-sensitive stocks are going to continue to get hammered this month. At this point, it looks like Trump's U.S. pullout is imminent, but that doesn't mean you should be dumping the rails. In fact, I'd treat the sell-off as a gift courtesy of Trump, since there are still many other reasons to be bullish on the rails.

I'd recommend keeping CN Rail on your radar, as shares may continue to retreat to double-digit territory. When it does, it's time to back up the truck.

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