A Rebound in Dividend Stocks May Come Sooner Than You Think

Description

Since the start of 2018, Canadian dividend stocks are underperforming the broader market. Analysts are blaming Canada's rising interest rates and expectations that more hikes are planned for the coming months for this poor showing.

The **S&P/TSX Composite Dividend Index**, which aims to provide a broad-based benchmark of Canadian dividend-paying stocks, is down 5.2% when compared to ~4% plunge in the broader market this year.

Investors generally shun large-cap, dividend-paying companies, such as **Enbridge Inc.** (TSX:ENB)(NYSE:ENB) and **BCE Inc.** (TSX:BCE)(NYSE:BCE), when bond yields rise as they hope to get a better return from the safe-haven government bonds than riskier equities.

Slowing economy

But the latest economic data suggest that investors may be too aggressive in pricing in further rate hikes in Canada. After a strong finish in 2017, Canada's economy is showing signs of a slowdown. The country lost a net 88,000 jobs in January, its largest monthly decrease since 2009, while retail numbers released in February showed sales fell 0.8% month-over-month in December.

A report on the nation's gross domestic product released last Friday confirmed that the slowdown is real, with data showing the economy growing at an annualized pace of just 1.7% in the fourth quarter, much slower than the 2.5% pace that Bank of Canada predicted in January.

That means the economy is back in line with what the central bank considers its non-inflationary speed limit, thereby reducing the pressure on policy makers to lift borrowing costs.

I think it will prove too difficult for Bank of Canada Governor Stephen Poloz to ignore this cooling in the economy when he meets with his policy makers on March 7 to decide about the future direction of interest rates.

Although the market is not expecting the bank to hike in this rate-setting meeting, the majority of analysts are convinced that at least two, and potentially three more rate increases will come before the end of the year.

Despite this bullish stance, I believe the realities on the ground are changing fast, especially when you take into account the growing risk of North American Free Trade Agreement (NAFTA) being scrapped altogether. President Donald Trump's announcement of duties on steel and aluminum on March 1 and Canada's threat to strike back are just some of the developments that require a wait-and-see approach.

The bottom line

These negative developments certainly don't bode well for the Canadian economy, and they will give the central bank enough justification to move on the sidelines after three rate hikes in the past 12 months.

However, this developing scenario is positive for the dividend stocks, which have lost their shine this year when compared to other asset classes. In Canada, some of the top dividend stocks are trading at a very attractive level, offering a great entry point to income investors. If you have some spare cash, this is the right time to put your money back to work and take advantage of high yields that may not last for long.

CATEGORY

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