If You Own These High-Yield Utilities, Buy More Before They Bounce Back

Description

We're right in the dead-centre of a rapidly rising interest rate environment and if you're a holder of utility stocks, you've probably felt like you're being backed into a corner with your conservative income investments.

Higher rates will raise financing costs for many capital-intensive, high-payout companies, so the large dividends of utilities (and other high-yielding defensive plays) just don't look as hot as they used to be.

While it may seem like an obvious choice to follow the herd by reducing your exposure to utilities (and the like) to adjust your portfolio to better profit off macroeconomic trends, I believe a better decision would be to stay the course in alignment with your individual investment goals.

If you're in a risk-averse investor, it just doesn't make sense to artificially increase your risk tolerance to avoid unavoidable burdens placed upon your high-income-paying names, especially since we're in the late stages of a bull market. While the dividends of utilities may be "less attractive" through the eyes of income investors, they're still best-in-class investments for those of us who value safety.

While the negative impact of higher rates eats into the long-term reward, it's still important to remember that the risk/reward trade-off is still worthwhile, especially when times get tougher. It may be painful to be a conservative income investor at these levels, but when the markets take a 360-degree turn, you'll be glad that you didn't substantially alter your strategy to increase your medium-term upside.

With the U.S. economy firing on all cylinders, many investors have rotated out of defensive dividend stocks and into cyclical names to make the most out of what appears to be a great situation for global markets. When the bear market inevitably rears its ugly head though, the price of admission for defensive dividend stocks (utilities, REITs, etc.) may finally go up, and as a risk-averse investor, you'd be glad you stuck with a "preservation-of-capital" strategy instead of giving into the "higher rates, utilities are bad" thesis that the general public has clearly adopted over the last year.

So, what's the best move for an income investor at this difficult juncture?

Buy more of your favourite utility stocks on weakness. Average down your cost basis and average up your dividend yield. By doing this, you'll be able to benefit from a more challenging environment for higher-yielding securities without increasing your overall portfolio's risk levels.

Moreover, the headwind of higher rates has already been factored in to shares after the recent decline. And in the case of some premium names, I think the decline has been overblown and could result in an upside correction over the near term, as investors shed their fear of higher rates and start to understand the implications to their personal investment goals.

Rather than making a rash decision, a more prudent strategy would be to take a contrarian position in some of the battered names that nobody seems to love anymore.

Fortis Inc. (TSX:FTS)(NYSE:FTS) and **Emera Inc.** (TSX:EMA) are two highly regulated utilities that have above-average growth profiles that'll likely fuel dividend hikes for years to come in spite of higher rates.

Fortis trades at a 16.4 forward P/E, a 1.3 P/B, and a 6.2 P/CF, all of which are lower than the company's five-year historical average multiples of 20.5, 1.5, and 7.5, respectively. The dividend yield, currently at 4.1%, is also 0.4% higher than it normally is.

Similarly, Emera trades at a 14.7 forward P/E, a 1.4 P/B, and a 6.2 P/CF, all of which are lower than the company's five-year historical average multiples of 19.6, 2.1, and 8.5, respectively. The 5.5% yield is over 1% than it normally is.

Both stocks are dirt cheap and make for impeccable long-term holdings for risk-averse income investors who want to protect themselves from the next crash.

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