Why You Should Avoid Buying Utility Stocks Today

Description

Investors love the dividends from utilities. Additionally, utility businesses tend to be stable, leading to growing dividends and stock price appreciation over time. So, oftentimes, utility stocks add stability to a diversified portfolio.

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Here are two popular utility stocks that I'll use as examples to discuss why it's not a good idea to buy utility stocks today.

Fortis

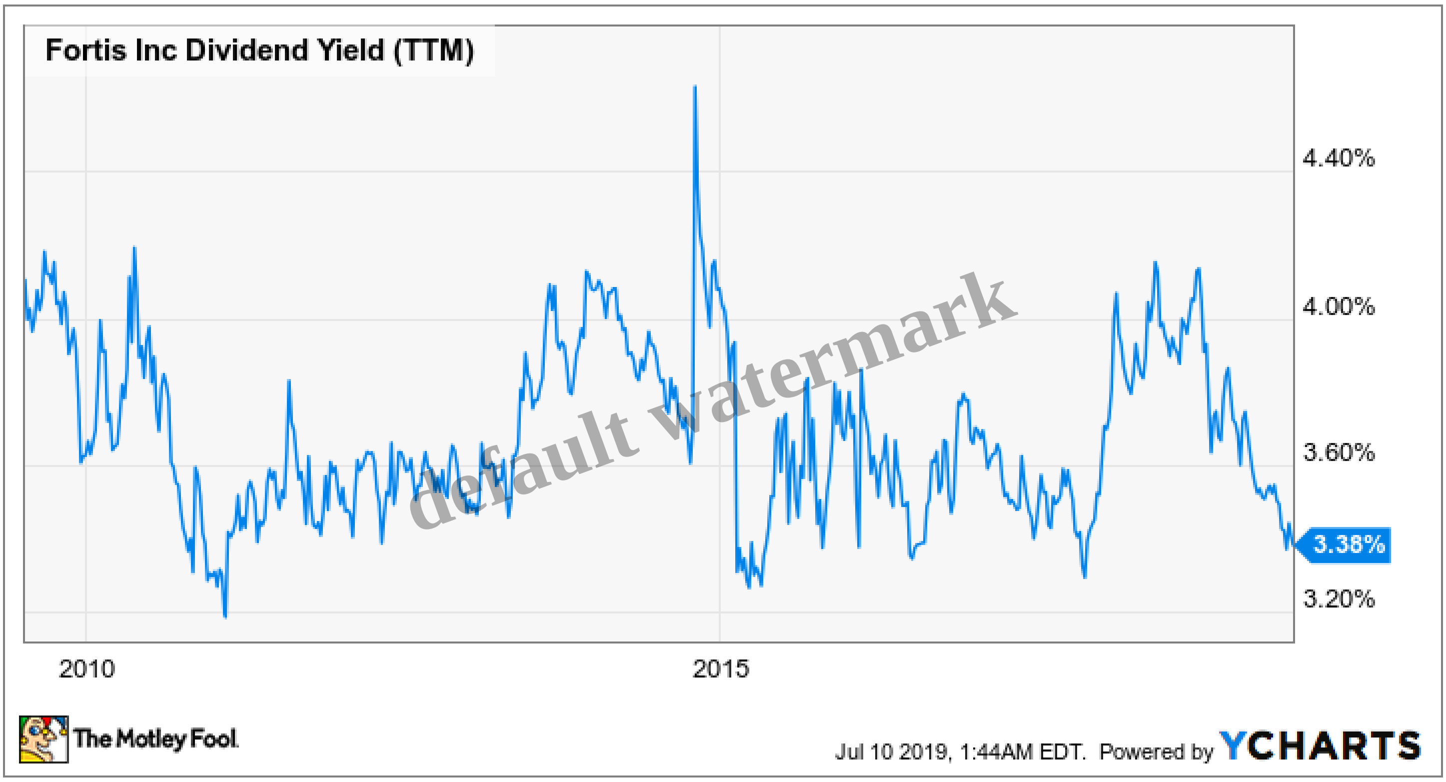
Fortis (TSX:FTS)(NYSE:FTS) is a proven regulated utility and one of the leaders in starting an increasing dividend. It's a top dividend growth stock in Canada for having hiked its dividend per share for 45 consecutive years.

The utility's dividend growth streak is set to continue as it forecasts annual dividend growth of about 6% over the next few years. Its consistency is what makes the quality utility stock popular in the investing community.

As a result, FTS stock tends to trade at a premium valuation. Its long-term normal price-to-earnings ratio (P/E) is about 19.5, while the stock trades at a P/E of roughly 20.3 at about $52.50 per share today. Consequently, in the best case scenario, the stock can only deliver total returns of about 7% per year over the next five years.

Analysts expect the stock to appreciate by only 2.1% over the next 12 months. Even if you throw in the dividend, total returns will only be about 5.5%, which is unattractive.

FTS stock offers a yield of 3.4%, which is at the low end of its 10-year yield range and another indication that the stock is on the expensive side.



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FTS Dividend Yield (TTM) data by YCharts

Algonquin Power & Utilities

Algonquin Power & Utilities (TSX:AQN)(NYSE:AQN) is a diversified utility that provides regulated water, natural gas, and electric utility services. On top of these regulated operations, it also develops and operates a renewable power portfolio comprised largely of wind generation.

The company is proud of having industry-leading dividend growth of about 10% per year that’s supported by earnings growth that’s growing faster than that, which means that Algonquin can improve its payout ratio over time while also increasing its dividend.

The utility has increased its dividend per share for eight years straight. With a number of ways to grow, including a five-year capital program of US$7.5 billion, Algonquin has the ability to continue growing its dividend.

At $16.19, AQN stock trades at a P/E of about 18.6, while it's estimated to grow its earnings per share by 6-8% per year over the next three to five years.

Analysts estimate that the stock will appreciate by only 1.2% over the next 12 months, indicating that the stock isn't a good value for your dollars today. Even if you throw in the dividend, total returns will only be about 5.3%, which is lacklustre.

Foolish takeaway

Utilities make great holdings to increase the income and stability of a diversified portfolio. However, it's not a good time to buy utility stocks right now because of their high valuations.

If you buy the stocks now, there's an elevated risk of their trading much lower over the next 12 months. Investors are urged to look elsewhere for dividends and value right now.

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