



How Safe Is Your Portfolio From “Zombie Companies?”

Description

With lower interest rates come great responsibilities — and debt-laden companies in the U.S. might eventually find those responsibilities are too weighty to handle. While the U.S. interest rate cut has been welcomed by North American markets, a believable threat to economic integrity remains in the form of so-called zombie companies: businesses that glut themselves on cheap credit and end up carrying dangerously bloated debt levels.

What is a zombie company, and should you be worried?

Typically, a zombie company is older than 10 years and can't make interest payments with its profits. Though it's been 11 years since the Fed last cut interest rates, it's been plenty of time for so-called zombie companies to arise. With an apparently bottomless supply of inexpensive capital on hand, such companies have amassed dangerous amounts of debt that could become toxic — and economists are only too aware of what happens in that scenario.

The last thing the situation needs is more cheap credit. The argument goes that more such companies will arise, and the pre-existing ones will be emboldened to carry on business as usual. A *New York Times* piece has posited that a sixth of all publicly traded U.S. companies are “zombies.” Another take is that the rate cut will simply make the next bubble worse.

So, where do Canadians stand in all this? Aside from the clear danger to our own economy that another 2008-style crash would pose (a Canadian recession could potentially follow a U.S. one after an estimated six to 12 months), the prospect of Canadian rate cuts is very much still on the table. If trade wars, weak inflation, and global trends in lowering rates lead the U.S. Fed to make a second cut, the Bank of Canada may well follow suit.

What should concerned investors do to stay safe?

Investors concerned that the perfect storm might be brewing south of the border may want to check what they're holding and swap out some of their weaker stocks with [high-quality, defensive companies](#).

Excellent choices would be utilities, while healthcare, apartment REITs, consumer staples, and gold are among some strong alternative areas for safety combined with recession-hardy growth potential.

Speaking of strength, **Fortis** ([TSX:FTS](#))([NYSE:FTS](#)) just declared a \$0.45 dividend, following on from its previous payment. With a forward yield of 3.46% on the table, Fortis is a defensive strong stock — one that can be confidently bought and forgotten about, and just right for a TFSA, RRSP, or other low-maintenance passive-income portfolio.

With 45 consecutive years of increased dividends, Fortis is a [top choice for passive-income growth](#). While adjusted earnings per share were down slightly in its most recent quarter, Fortis is as solid as its name suggests. From a highly diversified and almost entirely regulated asset base to a 6% dividend guidance, it's as safe an investment as any and could weather a broad North American correction.

The bottom line

While pundits are divided as to whether a recession is a legitimate concern right now, the fact that the U.S. Fed has lowered its interest rate in line with a global trend is symptomatic of a widespread slowdown. However, there are also other indicators of a coming correction; therefore, Canadian investors may wish to start battening down the hatches and removing dead wood from their stock portfolios.

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