This Is Why I am Selling (Some) of My Utility Stocks

Description

As an investor who primarily focuses on a buy-and-hold, low-risk value strategy, this seems a little anathema to my usual thoughts. But the situation today is volatile, and I believe in taking advantage of opportunities if they present themselves.

One such opportunity is the sale of some shares of utility companies. The past year has been extremely volatile for utility companies, with their values going from massively undervalued to very overvalued in the space of one year.

Last year, I had recommended using an overweight approach to dividend stocks. Many solid dividend-paying companies were sporting dividend yields that reached well over 5%, making them excellent buys. My initial sentiment was to buy a lot of these companies and hold them without ever selling for years. I thought that they would continue to have yielded over 5% for some time, growing at a decent clip for years.

But the huge, unforeseen run-up in share prices has caused me to re-evaluate my position on a portion of these fantastic yield hogs for reasons I will soon explain.

Their current yield is too small

I absolutely loved these stocks when their yields were 5-6% and was going to be pretty happy with the yield going forward. Therefore, out of sheer excitement, I used leverage to buy these shares, thinking that the dividend spread would be an excellent way to pay down the leverage over time.

When the fed and other central banks did the unthinkable and lowered rates, the situation changed abruptly. These stocks are now up anywhere from 20% to 40% — a huge gain for a stable, boring utility stock. I have decided, therefore, to sell off a portion of my shares and use those gains to pay down margin now and lock in a capital gain today instead of waiting for my dividends over time.

Emera (TSX:EMA), for example, was paying a dividend of over 6% when I bought the stock last fall. I was hoping it would rise so that the yield would stay over 5%, but with the capital appreciation shooting well past my expected annual return for the stock, I had to make a choice.

They are expensive

Last year, stocks were trading at a much more reasonable valuation than they are today. I would not have called them cheap, but they were certainly reasonable at P/E ratios of 12-18 times earnings and book values that hovered around one. Today, these same stocks trade at higher multiples in excess of what I want to pay for slow-growth stocks.

These stocks are positioned for a negative surprise

At the moment, most safe dividend stocks are priced for a recession. This could mean that any positive move in the economy might drive these stocks far lower. This would be doubly true if interest rates start moving up again. In the past 10 years, we've seen dividend stocks move sharply downwards several times. I think that the current price level makes them extremely susceptible to another retreat.

It's a good time to lock in profits

I like to buy and hold stocks and collect dividends. Therefore, I am not telling anyone to sell all of their dividend stocks. But if you have good gains, have any debt (margin or otherwise), or have seen these stocks grown to occupy too large a percentage of your portfolio, selling a small portion of them may be a good idea at current prices.

Personally, I have sold approximately one-third of my dividend stocks, although you have to keep in mind that I bought a lot using margin late last year. I hate having debt of any sort, so paying down the margin quickly using my 20-40% gains on my utility stocks was very appealing. Don't worry; I'm reasonably sure there will be a chance to buy these stocks again with fat yields sometime in the near future.

Of course, stocks like Emera are still must-own stocks. Everyone should have a core position in this company. Emera's solid, steady growth and highly regulated income make it a staple for all investors. But if you already have a big position and a good gain, definitely sell a little on the price spike.

CATEGORY

1. Dividend Stocks
2. Investing

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1. Editor's Choice

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Author
krisknutson