Retirees: 1 Easy Way to Get 86% More in Passive Income From Fortis (TSX:FTS) Stock

Description

I would buy **Fortis** (TSX:FTS)(NYSE:FTS) stock in a heartbeat, but only when it trades at a good valuation. Right now, it's the opposite of that.

At $55.50 per share as of writing, it trades close to a price-to-earnings ratio of 22! This is too expensive, even for the top-notch, low-risk utility.

A new investment in Fortis stock today is estimated to net "whopping" total returns of 3.5-5.5% per year based on its long-term normal valuation. To make things worse, the high valuation dragged down its yield to only 3.44%.

You'll notice that Fortis fairly recently raised its dividend in Q3. Investors will have to wait nine months for the next raise. Therefore, people looking to buy shares shouldn't be in a hurry to do so.

Retirees can find superior dividend stocks for passive income today.

That said, there is an easy way you can get an 86% boost in passive income from Fortis immediately. Here's how.

How to get a 6.4% yield from Fortis stock

Fortis first offered **Fortis Preferred Shares Series G** (TSX:FTS.PR.G) in May 2008 at $25 per share with an initial yield of 5.25%. Since then, Series G has had two resets, and the Bank of Canada interest rate has declined by roughly half.

As a result, the preferred stock now trades at $17 and change per share — a 31% discount from the $25. With a current quarterly payout, a fixed income of $0.2745625 per share, Series G provides a gigantic yield of 6.4% in comparison to the common stock's 3.44%. Specifically, it's 86% larger.

The next ex-dividend date for Series G is February 14. So, retirees and income investors have plenty of time to buy the stock.

Not so fast! What's the risk?

The stock prices of preferred shares are highly sensitive to changes in interest rates. If the Bank of Canada interest rate falls, stock prices of preferred shares, including Fortis Preferred Shares Series G, will also fall. However, the opposite case also stands — higher interest rates will push up their stock prices.

Preferred stocks are also much less liquid than common stocks. So, remember to set limit orders when you buy or sell.

Investor takeaway

Retirees and income investors should prefer the Fortis Preferred Shares Series G over the Fortis common stock today.

By buying the preferred stock today, you'll lock in a 6.4% yield for the next 3.75 years and collect 15 quarterly dividends (until the next reset in August 2023), unless you sell the stock beforehand.

Moreover, Fortis could redeem Series G for $25 per share, providing juicy gains of 45% for today's buyers.

However, as discussed, the Series G comes with markedly different risks than Fortis common stock. Additionally, Fortis is unlikely to redeem the preferred stock if interest rates stay low. Based on the current quarterly payout, the company is effectively paying out a yield of 4.393% for the Series G capital that it raised, which is low-cost debt.

Preferred shares are sort of a hedge for common stocks. Generally speaking, lower interest rates encourage investors to take more risk and invest for higher returns in common stocks, but higher interest rates will drive capital back into lower-risk, fixed-income investments like preferred stocks and bonds.

Investors should review their income portfolio and determine whether preferred stocks like Fortis Preferred Shares Series G make sense.

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