
# There Are Big Gains Ahead for Defensive Stocks in 2020

## Description

Growing uncertainty and rising economic as well as geopolitical risks are weighing on the global outlook. The outbreak of the coronavirus could have a sharp impact on not only China's economy but many around the world, especially Australia and Canada, which are dependent on commodity exports to drive growth. A sharp decline in commodity prices could precipitate another crisis among emerging markets like Argentina, Mexico, and Colombia, where fiscal excesses and softer growth have left them particularly vulnerable.



This has created an environment where defensive stocks such as utilities, consumer staples, and real estate investment trusts will thrive. One defensive stock that is a handy hedge against growing uncertainty and is poised to thrive, despite fears of weaker growth and rising volatility, is electric utility **Fortis** (TSX:FTS)(NYSE:FTS).

## Hedge against uncertainty

Electric utilities are excellent defensive stocks, because the inelastic demand for electricity means that their earnings are essentially protected from economic slumps. It is a heavily regulated industry, which has steep barriers to entry protecting participants from competition and enhancing the stability of their earnings. That means electric utilities like Fortis, which is a leading North American utility, can continue to deliver value, even if the economy tanks.

The outbreak of the coronavirus has triggered considerable fears about the health of China's economy, with it speculated that 2020 GDP growth could be up to two full percentage points lower than 2019. This has the potential to trigger a global downturn because of the heavily interconnected nature of the world economy.

China is the world's largest consumer of commodities, and stalled industrial activity will cause consumption to plunge, leading to waning demand, softer prices, and lower growth for many nations that are dependent on commodity exports to drive growth. If the economic outlook worsens, it will trigger a flight to safety among investors, which will give quality utilities like Fortis a solid lift.

Fortis has already gained a notable 20% over the last year, beating the **S&P/TSX Composite Index**, which only rallied by 13%, and there are signs that it will continue to make solid gains over the remainder of the year. The electric utility's considerable exposure to the U.S., where it generates 65% of its earnings, will boost Fortis's earnings, because the U.S. economy is expected to grow at a faster rate than Canada during 2020.

Furthermore, 99% of Fortis's assets are regulated, meaning that the income they generate is essentially guaranteed, as are regular increases, further enhancing the utility's ability to grow its earnings. Fortis has a five-year capital plan; it is investing $18.3 billion between 2020 and 2024 in developing its assets, with 99% of those funds being allocated to regulated assets and over half being invested in the United States. As those projects are completed, Fortis's earnings will grow.

Near historically low interest rates also boost the appeal of utilities as an investment, because it is a capital-intensive industry where many participants have borrowed large amounts of capital to fund their operations. Low interest rates makes debt cheaper, reducing the costs associated with servicing the capital they have borrowed.

## Looking ahead



The growing bearishness over the outlook for the global economy coupled with rising geopolitical and economic risk has created an ideal environment for defensive stocks. The increased unease surrounding financial markets means that even a minor crisis has the potential to spark a monumental flight to safety among investors, which would be a tremendous boon for defensive stocks.

Fortis is an ideal stock for investors seeking to hedge against an economic downturn and market slump. While investors wait for conditions to improve, they will be rewarded by its regularly growing sustainable dividend yielding an attractive 3.3%.

**CATEGORY**

1. Dividend Stocks
2. Investing

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