Top Canadian Stocks To Buy on an Interest Rate Cut

Description

Central banks across the globe are primed and ready. Given the negative impacts that COVID-19 is having on the economy, talk of rate cuts to spur economic spending is front and centre.

The first bank to cut rates was Australia, which did so late Monday evening. The interest rate was cut by 25 basis points to a record low 0.50%. Governor Philip Lowe released a statement explaining the reasoning:

"The coronavirus outbreak overseas is having a significant effect on the Australian economy at present, particularly in the education and travel sectors. The uncertainty that it is creating is also likely to affect domestic spending."

The expectation is that other G7 countries will soon follow suit. What does this mean for Canada? Well, companies with high capital expenditures such as utilities and pipelines stand to benefit. As these industries rely on debt to finance their capital programs, a cut in rates is a bullish catalyst.

Taking this into consideration, here are a couple of top stocks to buy on a rate cut by Canada's central bank.

Fortis

The largest utility company in Canada, **Fortis** (TSX:FTS)(NYSE:FTS) is well positioned to continue its outperformance. Over the past year, the company has gained 19.49% and has averaged a compound annual growth rate of 7.18% over the past 10 years.

In comparison, the **S&P/TSX Composite Index** has gained just 3.02% over the past year and has a 10-year CAGR of 3.31%.

Utility companies are considered to be defensive stocks in that they will do well regardless of economic condition. They tend to outperform in times of uncertainty. Case in point: Last week Fortis held up better than most, losing only ~8% of its value.

The company has $18.3 billion in capital project on the books through 2024, and a cut to rates will certainly help finance these projects.

Fortis is also one of the best income stocks in the country. As a Canadian Dividend Aristocrat, it owns the second-longest dividend growth streak in the country at 46 years.

It's a streak that will continue. The dividend is underpinned by regulated cash flows and Fortis has a targeted annual dividend growth rate of 6% through 2024.

Inter Pipeline

One of the smaller pipeline companies, **Inter Pipeline** (TSX:IPL) is one of the best positioned for outsized growth. The company is currently undertaking the biggest project in its history — the $3.5 billion dollar Heartland Petrochemical plant.

It's the first plant of its kind in Canada and is expected to add materially to Inter's EBITDA by an average of $450-500 million annually. This represents a significant increase from the 1.05 billion EBITDA generated in 2019.

Unfortunately, the project has been a big drain on cash and the company has had to take on a considerable amount of debt.

As of writing, the company expects to spend another $1.3 billion in capital expenditures over the next two years ($900 million in 2020 and $400 million in 2021).

As the company is already highly leveraged, it has little room for error. Inter Pipeline is a Canadian Dividend Aristocrat with an 11-year dividend growth streak.

The problem is that it yields a high 8.56% and the dividend accounts for 81% of company designated cash flows.

A rate cut could not have come at a better time for the company. So long as rates remain low and are trending downward, the company should have enough liquidity to maintain the dividend and put Heartland into operation by the end of 2021.

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