Why TSX Utility Stocks Outperformed in the Recent Market Weakness

Description

While almost the entire stock market turned weak, defensive stocks like utilities notably outperformed this month. **TSX** stocks at large fell by nearly 5%, but utility stocks soared by 5%. Top gainer stock **Shopify** has lost more than 20% in September. So, why did some of the strongest names turn pale and boring stocks outperform in the recent broad market weakness?

Recession-resilient business

Utility stocks are usually called "widow-and-orphan" stocks due to their stable dividends and slow stock movements. Due to their highly regulated operations, they earn a stable rate of return and stable cash flows. And that's exactly why they are more prone to pay stable dividends.

When broader markets turn rough, investors flee to unwavering sectors in order to protect the principal. Thus, utilities are generally their preferred choice in uncertain times.

Canada's top utility **Fortis** (TSX:FTS)(NYSE:FTS) soared more than 2% in September. It yields nearly 4%, higher than the broader markets. Along with yield, Fortis's dividend-payment history of 46 consecutive years is calming for investors.

Also, its dividend-growth rate for the next few years is expected to comfortably beat inflation — another plus for long-term investors. Fortis has returned almost 10% compounded annually in the last decade.

Lower correlation with economic or business cycles

Additionally, utility stocks have a much lower correlation with broader markets than high-growth tech stocks. That's why they generally outperform when markets trade lower. Similarly, tech stocks generally outperform defensives when markets rally.

Thus, diversification plays an important role, and utilities should have at least some exposure in your long-term portfolio.

Consider **Algonquin Power & Utilities** (TSX:AQN)(NYSE:AQN). This is one of the fastest-growing utilities and operates renewables assets as well. It generates a large portion of its earnings from regulated operations, which enables dividends stability.

It will pay $0.82 per share in dividends and yields 4.5%. Notably, Algonquin Power has returned more than 20% compounded annually in the last 10 years.

Low interest rates and utility stocks

The current environment of lower interest rates is particularly favourable for utilities. As they carry large amounts of debt, lower interest rates reduce their debt-servicing costs, which ultimately boosts profitability. Also, income-seeking investors switch to utilities amid falling interest rates in search of higher yields. This further gives a lift to utility stocks.

Canadian Utilities (TSX:CU) was an exception in the industry this month. The stock trended lower along with broader markets and lost 5% so far this month. It yields 5.5% at the moment, the highest among peers.

It has managed to increase dividends for the last 48 consecutive years — one of the longest dividend-increase streaks in Canada. CU stock returned 6.5% compounded annually in the last decade.

Interestingly, utilities will most likely continue to pay such steadily growing dividends for years to come. Their stable businesses and predictable earnings should fuel inflation-beating dividends.

Although they might not generate jazzy returns in the short term, stable dividend payments will protect your portfolio from the broad market volatility.

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1. NYSE:AQN (Algonquin Power & Utilities Corp.)
2. NYSE:FTS (Fortis Inc.)
3. TSX:AQN (Algonquin Power & Utilities Corp.)
4. TSX:CU (Canadian Utilities Limited)
5. TSX:FTS (Fortis Inc.)

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