Despite the Dullness, You Have to Have Utility Stocks in Your Portfolio

Description

Who would buy stocks that are growing just 8-10% annually when you have tech options that are doubling every year? Millennial investors might ask this question. However, a return should not be the only criteria while investing for the long term. You want to have an all-weather portfolio that should provide passive income and stability, too.

Why utility stocks?

Many investors overlook utility stocks, as they lack superior growth. However, when it comes to hedging broad market volatility and reliable dividends, even the biggest fund managers turn to utilities. In the 2008 financial crisis, utility stocks notably outperformed growth stocks and even the S&P 500.

Utilities operate in a highly regulated environment and generate a specific rate of return. For example, Canada's top utility **Fortis** (TSX:FTS)(NYSE:FTS) generates almost the entire of its earnings from regulated operations. They provide earnings and dividend stability, which notably reduces the risk for investors.

That's why Fortis has managed to increase dividends for the last 47 consecutive years. You would rarely see such a long dividend-growth streak in high-growth tech stocks. Fortis yields 4% at the moment. The stock has returned more than 180% in the last decade, including dividends, outperforming Canadian stocks at large.

Interest rates and utility stocks

Interest rates across the globe have hit record lows this year amid the pandemic. Investors should note that utility stocks and interest rates usually trade inversely to each other. Income-seeking investors shift to utility stocks amid lower interest rates in search of higher yields. This further gives a push to utilities.

Utilities bear a large amount of debt on their books, and lower interest rates lower their debt-servicing costs, eventually improving their profitability.

If you are looking for reasonably higher growth along with safety, consider **Algonquin Power & Utilities** (TSX:AQN)(NYSE:AQN). The stock has returned almost 700% in the last decade, absolutely thrashing Canadian utility stocks and broader markets.

Algonquin's high-growth renewables operations provided a necessary push to its earnings growth in this period. It is trading at a dividend yield of 4%, marginally higher than TSX stocks at large.

Utilities do not have a swanky business model or a striking growth that doubles your money every few years. However, they stand tall when markets at large take an ugly turn. Regardless of the economic conditions, people use electricity and gas, which facilitates stable cash flows for utility companies.

Algonquin aims to increase dividends by 7% per year, while Fortis is aiming for a 6% increase for the next few years. While that may seem ordinary against some dividend aristocrats, their stable, visible payout increase certainly stands tall in these volatile times.

The Foolish takeaway

Utility stocks generally are less correlated with broader markets. That's why they outperform in bearish markets.

Thus, irrespective of your risk appetite, you should park around 10-20% of your portfolio in utility stocks. The passive income generated by such a modest allocation will take care of your expenses in your sunset years.

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