Why You Should Have Utility Stocks in Your Portfolio

Description

Investors perceive utility stocks as boring and unrewarding. Certainly, why would one find them interesting when there are stocks that are doubling every year? Utilities are slow moving and do not have a jazzy business model. However, they offer some unique set of advantages that none of the other sectors offer.

Utility stocks: Stable dividends and slow-moving stocks

Utilities operate in a regulated environment and make a specific rate of return. That's why they generate stable cash flows in almost all economic situations, facilitating stable payouts for shareholders. Thus, investors turn to relatively stable, recession-resilient utility stocks when the economic downturn looms.

Consider top utility stock **Fortis** (TSX:FTS)(NYSE:FTS). It makes a large portion of its earnings from regulated operations. Higher exposure to regulated operations enable earnings stability and visibility. That's why Fortis has managed to increase dividends for the last 47 straight years. It yields close to 4%, higher than TSX stocks at large.

Utility companies give away a large chunk of their earnings to investors in the form of dividends. Fortis distributed almost 75% of its earnings as dividends. Interestingly, such a high payout ratio is not unusual for utilities.

Peer stock **Canadian Utilities** (TSX:CU) has an average payout ratio close to 80%. It also generates a majority of its cash flows from regulated operations. The stock yields 6%, way higher than TSX stocks. The yield premium against some high-quality bonds is what makes them attractive in a low-interest-rate environment.

Valuable in low-interest-rate environments

Normally, interest rates and utility stocks trade inversely to each other. Income-seeking investors move to utility stocks amid lower rates in search of higher yields. This further gives a push to utilities.

Additionally, due to their heavy capital requirements, utilities carry a large pile of debt on their books. So, lower rates decrease their debt servicing costs, ultimately improving their profitability.

Driven by stable dividends and fair capital growth, utility stocks have made a decent fortune for investors in the long term. Fortis has returned 13% compounded annually in the last 20 years, while Canadian Utilities stock has returned 10% compounded annually in the same period. That notably beat TSX Composite Index.

Another Canadian utility stock **Emera** (TSX:EMA) has also been a stable money grower for investors. It yields 5% at the moment. It has returned 11% compounded annually in the last two decades.

Low correlation with broader markets

Another critical advantage of utilities is their low correlation with broader markets. Utility stocks have a low correlation with broad market indexes than high-growth tech stocks.

When the volatility in broader markets increases, investors move to relatively firmer sectors in order to protect the principal. Thus, utilities are generally their preferred choice in uncertain times.

That's why we may see broad market indexes fall 20% amid the recession fears, but utility stocks fall maybe just 10%.

Bottom line

Thus, diversification across sectors plays a significant role, and utilities should have at least some exposure in your long-term portfolio. Utilities might seem dull on the face of it, but stability and dividends play a big role in driving shareholders' total returns in the long term.

CATEGORY

1. Coronavirus
2. Dividend Stocks
3. Energy Stocks
4. Investing
5. Personal Finance
6. Stocks for Beginners

TICKERS GLOBAL

1. NYSE:FTS (Fortis Inc.)
2. TSX:CU (Canadian Utilities Limited)
3. TSX:EMA (Emera Incorporated)
4. TSX:FTS (Fortis Inc.)

PARTNER-FEEDS

1. Business Insider
2. Koyfin
3. Msn
4. Newscred
5. Quote Media
6. Sharewise
7. Yahoo CA

Category

1. Coronavirus
2. Dividend Stocks
3. Energy Stocks
4. Investing
5. Personal Finance
6. Stocks for Beginners

Date
2025/07/05
Date Created
2021/03/08
Author
vinitkularni20