Inflation Is Skyrocketing, But Bond Proxies Will Do Okay

Description

Bond yields are once again on the rise, as investors bet on higher inflation expectations. Thus, there's an expectation that certain bond-like sectors could underperform for some time.

Certainly, investors in companies like **Fortis** (TSX:FTS)(NYSE:FTS) may be concerned about rising bond yields. After all, it's certainly a big headwind. However, as far as quality stocks go with bond-like yields, Fortis is about as good as it gets. Despite rising bond yields, I still believe this is a stock long-term investors should own.

Fortis fundamentally strays away from how a bond stock functions

Despite a pandemic-ridden 2020, Fortis came out of the fray relatively unscathed. In fact, annual adjusted earnings were on the rise once again in Q4. However, throughout February, Fortis shares fell more than 5% to reach prices last seen in 2019.

The yield on 10-year U.S. Treasury bond reached its highest value since the pandemic, moving to 14-month highs around 1.75% at the time of writing. Considering the economic turmoil that the country went through, this is a massive jump. This increase inherently makes bond-like dividend yielding equities less attractive as well.

Yes, bond yields are rising. But since bond prices and yields move inversely, this market is also to blame for falling bond prices. Since Fortis is viewed as a bond-like equity, it also drops when investors anticipate inflation, strong economic growth, or an increase in central bank interest rates.

Higher bond yields also reduce the value of the dividends these companies provide. That's because if investors are given the choice between risk-free (or lower-risk) bond yields, which are getting closer to higher-risk equity yields, investors can choose to move down the risk spectrum to bonds.

Solid income over decades is a testament to its long-term potential

That said, the Canadian utility firm Fortis is a great company with growing cash flows. In fact, I would classify this company as one that defies the stereotypical view that utilities lack growth potential. Rather, this company has aggressively ventured into new markets, which has fueled its growth potential over time.

As utilities expand and Fortis invests in renewable energy, I think this firm can easily continue to raise its dividend over time. This is where the true value in Fortis lies.

Fortis is a great income producer, raising its dividend each and every year. Its current yield hovers close to the 4% mark, which might not look substantial. However, this yield is extremely stable and continues to grow consistently.

Over the last decade, Fortis's total return has been 7.8% compounded annually, which is better than most other defensive stocks on the TSX.

I think one of the primary reasons why Fortis continues to enjoy slow, yet steady growth is its monopoly-like power in the tightly regulated electricity sector. This is unlikely to change over time, ensuring Fortis's market position and ability to continue hiking its dividend distributions over time.

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