Are Dividend Stocks the Best Way to Protect Against a Potential Recession?

Description

Recession fears continue to fuel the markets, seemingly from all angles. Whether it's COVID-19 lockdowns in China, the crisis in Ukraine, supply-chain demands or labour shortages, you can pick your poison. Interest rates continue to rise both here and across the border, leading to analysts wondering when, not if, a recession is coming.

It's times like these that Motley Fool investors look to how to protect their portfolio from a recession. And a popular choice is by investing in dividend stocks. But is this the best way?

What happens during a recession?

Recessions are a normal part of economic cycles. Look back over the last few decades, and you'll see several, most recently in 2008. But these have been happening for over 100 years.

So, the good news is, during that time economists have been coming up with strategies investors can use to protect themselves during a recession. After all, it's a widespread period of extended decline that affects investors big and small. So, *someone* was bound to come up with strategies.

First it's important to note what's bound to go first, and that's growth stocks. As you've probably noticed, tech stocks in particular continue to suffer greatly after experiencing stellar growth through 2020 and 2021. So, this is likely to continue during a recession and may take a considerable amount of time to recover.

So, where should investors look instead?

Think big

Motley Fool investors should consider large, blue-chip companies with steady cash flow that means they can continue to produce dividends. These companies tend to outperform during economic downturns, including recessions.

What you'll want to find are household names within large industries. This might be telecommunications, transportation, energy, and financial institutions. Then look back and see which companies have a solid track record of weathering these storms and recovering quickly.

That would mean finding a company with a strong balance sheet, solid cash flows, and little to no debt. So, this could mean commodities like food and beverages do well over something like car makers and tech companies. These are companies that provide necessities rather than items consumers buy when they have extra cash.

Some options

Let's look at some companies that could fall within this category: large, blue-chip companies that have solid histories of cash flow and dividends and the potential for more in the future. They have to be around for decades and could be around for decades more.

I would look first to the railway sector, and **Canadian National Railway** (TSX:CNR)(NYSE:CNI) is a top choice. True, it lost the bid for Kansas City Southern. But now it doesn't have a huge amount of debt to handle. It provides transportation for consumer goods across Canada and is coming up on the spring and summer season, where crop yields increase its cash flows.

Then there's the banking sector. The United States banks don't fare too well during a recession, but Canadian banks are protected by credit loan losses. And they didn't use them all up during the pandemic. Now, these are perfect institutions to invest in and take advantage of at significantly low rates. Today I would consider the largest and go with **Royal Bank of Canada** (TSX:RY)(NYSE:RY) for ultimate protection.

Both offer dividends

Both of these TSX stocks offer dividends for investors to take on as well. Their cash flows remain solid, they've been around for over 100 years, and they have increased their dividends at stable rates. They don't have huge debts to handle and look to have more growth in the future.

With CNR stock, you'll receive a dividend of 1.94% as of writing, and Royal Bank stock offers a 3.7% dividend yield. Now, I wouldn't say dividend stocks are the be all, end all when it comes to protecting yourself against a recession. However, it certainly helps when you've already chosen strong dividend stocks to have in your corner in an economic downturn.

CATEGORY

1. Dividend Stocks
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3. TSX:CNR (Canadian National Railway Company)
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Date
2025/07/26
Date Created
2022/05/07
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