TSX Utility Stocks in Focus as Recession Talks Gain Steam

Description

Investors often overlook utility stocks because of their slow-moving stocks and subdued growth. However, it's not prudent to always focus on growth. When markets turn rough, stability matters more. For example, Canadian tech giant **Shopify** more than doubled during the pandemic, notably outperforming utility stocks. However, in the last six-odd months, TSX utility stocks have gained 10%, while Shopify has lost 80%.

What's so special about utility stocks?

Though utilities offer subdued growth prospects, they have some of the unique advantages that none of the other sectors offer. They operate a stable business model in a highly regulated environment. This provides high earnings visibility in almost all economic scenarios.

Consider **Fortis** (TSX:FTS)(NYSE:FTS). Fortis has witnessed a below-average earnings growth for the last several years. It generates nearly entire of its earnings from regulated operations. So, even during a recession or an economic boom, demand for utilities stays somewhat similar, which provides earnings stability. As a result, utilities like Fortis pay regular dividends to their shareholders.

Fortis stock currently yields 3.4%, which is in line with TSX stocks. Moreover, it has managed to raise shareholder payouts in the last 48 consecutive years. Note that Fortis will likely keep paying rising dividend, even in a recession. That's why market participants switch to safer stocks like FTS when recession fears rise.

Generous dividends

Another thing to note is that utilities are some of the generous entities in the markets when it comes to dividend payments. They distribute a significant portion of their earnings among shareholders as dividends. Generally, the number stands upwards of 70-75% of the total profits while broader markets pay around 20%! In the last two years, Fortis's payout ratio averaged about 60%.

Peer utility stock **Canadian Utilities** (TSX:CU) has a payout ratio above 100%. That means it paid more in dividends than what it earned during a particular period. It currently yields 4.6%, which is higher than FTS. Note that it has increased its dividends for the last 50 consecutive years.

Apart from earnings and dividend stability, utility stocks show a lower correlation with broader markets. So, for example, when the TSX index falls by 1%, utilities might fall by less than 1%. As discussed earlier, investors switch to safe havens like utilities by dumping growth stocks. When markets crashed during the pandemic in March 2020, Fortis notably outpaced and also kept its dividend-growth streak.

Bottom line

Utility stocks will not make you rich overnight, but they present stability when growth names flounder in volatile markets. Also, their regularly growing dividends significantly contribute to total returns over the long term. FTS has returned 11% per year in the last 10 years, which is almost double what TSX stocks on average returned. In comparison, CU stock returned 6% on average annually in the same period.

So, in a nutshell, even if you are an aggressive investor, having some exposure to utility stocks will provide much-needed stability to your portfolio in uncertain times.

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