Forget Clorox! 1 Defensive Passive-Income Stock to Buy in August

Description

Passive-income stocks have been holding their own far better than your average high-tech play. Though dividend stocks with defensive traits may be enticing at a time when the markets are exhibiting extreme levels of volatility, I'd argue that investors should be mindful of valuation.

Sure, defensive plays are prudent moves to make ahead of a potential economic contraction. Defensives can hold their own quite well when a recession hits and the markets crumble under the pressure. Still, many defensive stocks are bid up by quite a bit, especially the consumer staples names in the United States.

Valuation always matters. As the markets reach a turning point, defensives could lag the risk-on growth plays, as they look to recover some of the ground lost in the first half of the year. While I'm not against being a buyer of defensive dividend stocks here for their passive income, I think that investors must put in the extra due diligence. Not all defensive dividend stocks are incredibly expensive. However, many are trading at levels that could act as a drag on long-term total returns.

Defensive dividend stocks are only smart buys if you don't overpay!

Consider shares of bleach maker **Clorox** (NYSE:CLX), which fell more than 2% on Wednesday, while the rest of the market blasted off, posting one of its best days in recent memory. The stock got expensive, and receding recession fears were enough to keep the stock from rallying alongside the averages.

At writing, Clorox stock trades at a hefty 38.5 times price-to-earnings (P/E). That's well above the 34.7 P/E that household product industry average and well above the S&P 500's P/E, which is estimated to be around 19.8.

Undoubtedly, playing defence is wise, unless, of course, you're overpaying at a point of maximum pessimism. As the markets look to be more constructive going into year's end, it may be a better idea to scavenge the wreckage for modestly priced defensives like **Fortis** (TSX:FTS)(NYSE:FTS).

Fortis stock: A defensive dividend stock that's actually quite cheap

Fortis is a utility company with a recession-resilient operating cash flow stream and a stable 3.56% dividend yield. The stock is seen as a "safe haven" or "bond proxy," making it intriguing when market fear and panic mount.

Despite the higher demand for defensive holdings, Fortis stock remains relatively cheap. The stock trades at 23.4 times P/E and three times price to sales (P/S). Both popular valuation metrics are below that of the electric utility industry averages of 34.4 and 2.2, respectively.

Inflation has been a major thorn in the sides of firms like Fortis. In Canada, 8.1% inflation will eat away at the profitability of highly regulated utilities like Fortis. The need for higher rates also raises borrowing costs for the company, as it looks to grow its bottom line.

In any case, look for Fortis to continue doing its best to manage inflationary headwinds. The company still expects to payout around 70% of its profits via dividend payments. With plenty of growth projects in the pipeline, dividend hikes averaging 6% per year should be expected moving forward.

The stock is down around 7% from its all-time high of around $65 per share over inflation woes. I'd look to be a buyer of the dip for those looking to play defence without having to pay up hand over fist on stocks such as Clorox.

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