Pair Trade of the Year? 2 Stocks to Buy Together for 2023

Description

Investors are feeling quite uneasy these days, with rampant volatility continuing to weigh on sentiment. As concern goes from inflation to a recession, many wonder if there are more negative surprises on the horizon that can feed this bear market.

Despite the doom and gloom expected for 2023, new investors should stay the course if they're able. In this piece, we'll have a closer look at two intriguing stocks that would make for a great pair trade in the new year.

Algonquin stock: Power your portfolio in 2023

Undoubtedly, there are plenty of bargains in the Canadian stock market. Some portfolio staples have been weighed down more than others.

Dividend studs like **Algonquin Power & Utilities** (TSX:AQN) went from a steady dividend-growth gem to a name that could be at risk of a dividend reduction. It's a tough environment out there, but I think that negativity is beginning to overswing to the downside. At the end of the day, investors seeking to jump in here should be willing to endure more of the same for at least another few quarters.

At writing, shares of Algonquin Power are trading just below $10 per share. Year to date, the stock is down a whopping 45%. And from its 2021 all-time highs, the name is off more than 55%. There's no question that the valuation reset has been vicious. It's also hard to believe that the stock was one of RBC's top energy picks prior to its implosion.

Indeed, few investors would have thought a steady player like Algonquin would have its share price be cut in half, with talks of dividend cuts on the table. The company has many years of consistent dividend increases. Still, even rich histories of returning capital to shareholders aren't enough to guarantee a dividend's security.

From dividend darling to the chopping block

It seems like all it took was a few months for AQN stock to go from a reliable dividend grower to an at-risk play. Looking ahead, Algonquin has many challenges it'll need to tackle. Higher interest rates have taken a stride out of the company's growth step, and recently reduced guidance could paint an ugly picture for the health of the dividend, which currently yields a staggering 9.64%.

Though Algonquin isn't the steady growth stock we once thought it was in the face of rapid-fire rate hikes, I think the damage has been overdone. There exist many scenarios where the dividend can be kept intact. However, at this pace of earnings, the company may have an easier time just reducing the dividend by a modest amount.

Such a cut, I think, is already baked into shares. At 1.9 times sales, AQN stock is the cheapest I've seen it since the depths of the 2020 market selloff. Further, the quick pace of analyst downgrades has also caused many to throw in the towel with the intent of asking questions later.

The perfect pairing for AQN stock?

My biggest concern about Algonquin is the lack of clarity on the growth profile, as we navigate this higher-rate environment. Indeed, the guide could be downgraded again in a bear-case scenario. That's why I'd pair Algonquin with a more certain name like **Hydro One** (TSX:H).

Hydro One has a huge moat surrounding Ontario's transmission lines. Even as recession hits, Hydro One's cash flow stream isn't expected to fluctuate wildly. With less exposure to higher interest rates and less in the way of potential surprises, investors can seek shelter in the name.

With a very safe 3% dividend yield and a 0.27 beta (a beta below one means shares are less volatile than the TSX Index), H stock makes for a great pair for investors tempted by a falling knife like Algonquin stock.

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