2 TSX Utility Stocks to Buy and 1 to Avoid in 2023

Description

Investors who had higher exposure to defensives were relatively better off last year. Going into 2023, staying with the defensives seems like a prudent move as of now.

Utilities are classic defensives for several reasons. Even if the broader economy sees a "hard landing" in 2023, utility companies will likely keep growing because of their large regulated operations. Their stable dividends stand way taller in volatile markets. Plus, utility stocks are less correlated with equities at large. So, when markets tumble, utilities outperform.

Last year, TSX utility stocks were some of the laggards and burned considerable shareholder wealth. But that was quite on the expected lines amid rapidly rising interest rates. The pace of rate hikes might slow down or rather pause in the second half of 2023. So, this makes it an apt time to bet on utilities.

Here are the top TSX utility stocks one can consider for their defensive portfolio.

Fortis

Fortis (TSX:FTS) is one of Canada's biggest and most stable utility stocks.

It currently yields 4%, and the stock has lost 10% in the last 12 months. That's a considerable drawdown for a utility stock. But if we see the awaited respite on the rate hike front, stocks like FTS could see a decent recovery.

Moreover, if a recession hits this year, you will likely be better invested in FTS than any other risky growth stock. Fortis has seen several economic downturns in the past and has emerged stronger through each one. Be it the pandemic or the 2008 financial meltdown, the global electric utility has kept its dividend growth intact. Its earnings visibility and balance sheet strength make its dividends reliable.

Fortis aims to increase shareholder payouts by 5% annually for the foreseeable future. Its less volatile stock and steadily growing dividends make it an appealing bet for conservative investors.

Hydro One

Another interesting bet in the utility space is **Hydro One** (TSX:H). It is Ontario's largest transmission and distribution utility serving nearly 1.4 million customers.

The Hydro One dividend currently yields 3.3%, and the stock has soared 12% since last year. Unlike peers, it is not involved in power generation but only deals with power transmission and distribution. This makes it a further low-risk bet among TSX utilities. Notably, it makes 99% of its revenues from rate-regulated operations, enabling cash flow stability and visibility.

Hydro One intends to raise dividends by 5% per year, which seems achievable with its rate base expanding by 6%. With stable earnings and dividends, Hydro One stock could be an exciting investment proposition in these volatile markets.

Note that utility stocks are not suitable for all kinds of investors. They are low-risk options with relatively low growth prospects. Here's the one TSX utility stock I'd avoid.

Algonquin Power and Utilities

Algonquin Power (TSX:AQN) stock saw a 34% value erosion in the last two months when the company's earnings notably declined. Thanks to rising rates, Algonquin's interest expenses rose sharply, bringing its Q3 profits notably lower.

Such crude surprises are rare among utilities. However, there could be more from Algonquin in 2023. Its profitability could further take a dent amid its bloating balance sheet. Plus, the company might have to trim down its dividends to remain on the safe side.

So, even if its current yield looks attractive, it might normalize soon. The stock will most likely keep trading under pressure, given the potential dividend cut and earnings drop. Compared to Algonquin, the above two TSX utility stocks offer a much better risk-reward proposition.

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1. TSX:AQN (Algonquin Power & Utilities Corp.)
2. TSX:FTS (Fortis Inc.)
3. TSX:H (Hydro One Limited)

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