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# Safety in pipelines and utilities

Hedge your portfolio in volatile markets

Investors looking for opportunities to hedge their bets in volatile markets might consider pipeline and power utility stocks. Although these stocks are not particularly exciting, they offer a number of appealing benefits.

According to Canaccord Genuity analyst Juan Plessis, the group generally tends to outperform during market downturns as investors look for places to weather the storm. The group's performance is also driven when the outlook improves and investors slowly ease back into the markets, shifting from cash to conservative equities before venturing into more growth-oriented investments.

The group is considered a good leading indicator, often rebounding ahead of a stock market recovery by approximately one or two months and fully participating in the initial stages of the recovery. When examining absolute performance, the group tends to do as well as the overall market but on a much more risk-adjusted basis.

Much of that is due to the defensive nature of the sector. Utility companies provide basic necessities of life, such as warmth and electricity, so their products and services are essential regardless of the state of the economy.

The utility sector is also a favorite with dividend-focused investors. According to Plessis, Canadian utilities are now trading with historically high dividend yields and historically low price-earnings ratios relative to interest rates. Utilities also have historically better total returns on a risk-adjusted basis than the overall stock market.

The dividends received from Canadian utility companies provide investors with some significant advantages, including tax efficiency. On an after-tax basis, dividends are generally worth 1.31 to 1.45 times more than the earnings on interest income.

An Ontario investor in the highest tax bracket, who receives $100 of dividend income, would retain $71.81. Assuming the dividend-producing investment was a stock yielding 4.0%, the investor would have to buy a bond with at least 5.36% yield in order to get the same after-tax income.

Investors in the lowest tax bracket have an even greater advantage. With the tax credit mechanism, they often receive more than the value of the dividends. For example, in Ontario those investors get $103.93 for each $100 and in BC they get $109.42.

Canaccord Genuity analysts favor good quality pipeline and power utility stocks with solid dividends and the potential for capital appreciation. Their current equity picks include Canadian Utilities (TSX: CU), Emera Inc. (TSX: EMA), and TransCanada Corp. (TSX: TRP).

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Given the current market volatility, a defensive approach is a wise approach. When assessing utility investments look for quality and take advantage of market dips to add to positions.

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