How Cautious Millennial Investors Should Approach the Market

Description

It seems the term “cautious millenial” actually refers to most millenials, according to a 2014 survey by Bankrate.com. Despite the impressive performance of the stock market, with the TSX increasing 123% over the past 72 months and averaging a 9.9% return since inception, millenials overwhelmingly prefer low-risk investment options.

Case in point: the most preferred investment for millenials—with a 39% majority—is cash. This is followed by 23% preferring real-estate, and only 19% preferring stocks. The remainder preferred bonds and precious metals.

Is this kind avoidance of equities wise for millenials? On one hand, it can be justified—many millenials still have fresh memories of the great recession, where stocks dropped nearly 50%. Couple this with a weak job market and record levels of student debt, and there is a rationale to gravitate towards low-risk investments.

There is, however, an even stronger argument to stay in equities—stocks have historically outperformed every other asset class. If you invested a mere $100 in the TSX in 1950 and reinvested all proceeds, it would be worth nearly $40,000 by the end of 2013—a staggering 400 times return on investment. This same $100 invested in U.S. stocks would be worth $83,000 dollars over the same 63 year period.

One point is important to note—these impressive returns occurred despite the fact that 12 substantial bear markets have occurred during the aforementioned time frame. If we assume that 63 years of history can tell us something about the next 63 years, then avoiding or under-allocating stocks could literally be a multimillion dollar error.

Investing in stocks does not have to be high risk

There is somewhat of a misconception that investing in stocks needs to be high risk, but the reality is that by selecting stocks wisely it is possible attain a very favourable risk/reward ratio. In this regard, it is possible to still participate in the tremendous upside of the stock market, while keeping downside risk to a minimum.

The key is to choose stocks with growing dividends, a wide economic moat, and a decent, very visible long-term growth profile. Research by **JP Morgan** found that not only do these “boring” stocks outperform over the long-term term, but they also are much less volatile, and therefore less risky.

In Canada, two stocks stand out in this regard. The first is **Enbridge Inc.** (TSX:ENB)(NYSE:ENB). Enbridge is Canada's dominant pipeline player and an impressive 85% of its earnings are underpinned by regulated, cost-of-service contracts. This means that Enbridge is guaranteed to out-earn its cost of capital on the majority of its assets. In addition, many of these contracts are 20+ years in length and tied to customers with low-decline assets that often have over 40 years of reserve life.

The result is that Enbridge has incredibly safe, stable earnings. This stability comes with a very impressive growth profile as well. Enbridge has a $44 billion capital program underway, which should drive 10-12% annual earnings growth going forward. With a dividend that's increased every year since 1953 and is expected to grow by 14-16% annually going forward, this is a low-risk, high-return play for even the most cautious millenial.

Potash Corp./Saskatchewan (TSX:POT)(NYSE:POT) is a second stock with a solid risk profile. Although more risky than Enbridge because it sells fertilizers, which are volatile commodities, Potash Corp. occupies a dominant global position, and is poised to benefit from the huge increase in fertilizer demand as emerging economies need to grow more food with decreasing arable land.

As the largest global producer of potash (producing 20% of global supply and 50% of new global supply coming online), Potash Corp. is best suited to benefit from increasing demand for food. In addition, there are very high barriers to entry in the potash business. As a result, there are very few producers because it is estimated to cost $6 billion and a minimum of seven years to get a potash mine running. This protects Potash Corp.'s revenue, and with a 3.91% yield, Potash Corp. is an excellent stock for a young investor to buy and hold.

CATEGORY

1. Dividend Stocks
2. Investing

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1. Editor's Choice

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1. NYSE:ENB (Enbridge Inc.)
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