How to Reduce Risks of Investing in Stocks: Part 3

Description

Investing in stocks historically gives higher returns than placing money in bonds, GICs, or the savings account. With higher returns comes higher risks. Here I will talk about two risks that come with investing in stocks and how to reduce those risks.

In the Part 1 article and Part 2 article, I discussed about four risks of investing in stocks and how to reduce those risks. The risks are risk of capital loss, volatility risk, valuation risk and risk of unforeseen market crashes.

In this article, I will discuss three more risks that come with investing in stocks.

5. Individual Risk: Know your own Temperament

Don't let anyone else tell you how to invest. You don't know which style of investing fits you until you try it. Try out various styles that you're comfortable with and find out for yourself which fits you best! Perhaps you feel it's best if you had a portfolio of 50% dividend stocks, 20% growth stocks, 20% bonds, and 10% cash.

For example, if you're starting with $17,500 for the stock portfolio portion, you can choose four top quality companies from diversified industries. You could buy $5000 in each of **Fortis Inc** (TSX:FTS), **Royal Bank of Canada** (TSX:RY)(NYSE:RY), and **Enbridge Inc** (TSX:ENB)(NYSE:ENB), and buy $2500 in **Metro, Inc.** (TSX:MRU).

It goes without saying that it helps to read investing books, Motley Fool, and to learn about different strategies so that you know the basics before you start. No matter what you end up choosing, start with small enough amounts that you're willing to lose. But go in trying hard not to lose.

Ways to reduce individual risk

- Know yourself, and update your investing plan periodically as you learn more about investing.
- Each time you buy or sell, write down briefly the reasons why. For example, "Adding to a core holding after a 10% pullback to fair valuation", or "Buying for a trade with an estimation of 10% to

20% gain in 6 months”.

- Remember to go back to those reasons and see how they play out. Other than learning from reading, learning from doing is just as if not more important.

6. Individual Risk: Unable to Manage Portfolio

This is about planning for the unplanned. What happens when I become sick and need to stay in the hospital? What happens if I’m gone tomorrow? Who does the portfolio go to? Who has the ability or power to manage it? Does your spouse or your children have the knowledge and experience to handle the portfolio?

Ways to reduce individual risk

- Prepare for when you maybe unable to manage the portfolio yourself.
- Write down who is in charge or the steps to execute.
- Perhaps even involve the beneficiaries of the portfolio in the portfolio management process.

7. Risk of a negative returns

Finally, there’s the risk of negative return. That is, the market could crash anytime, or the stocks you bought last year keep going lower and your money is stuck in the market. Want to know what I mean? Look at the multiple year price charts of any oil-related companies such as **Suncor Energy Inc.** (TSX:SU)(NYSE:SU), or any miners such as **Teck Resources Ltd** (TSX:TCK.B)(NYSE:TCK) and **Silver Wheaton Corp.** (TSX:SLW)(NYSE:SLW).

You cannot help it if individual stock holdings don’t do well, but if you did things right, your portfolio should appreciate in value overtime, setting aside market crashes and industry crashes.

Ways to reduce the risk of negative return

- Buy dividend stocks. Receive dividends even in a down market. The dividend gives you a positive return no matter what the market does.
- Buy at proper valuations. This helps mitigate price declines, but it doesn’t mean a weak stock won’t go lower.
- Diversify. Buy businesses with stable earnings from different industries. When an industry-specific problem occurs, your holdings from other industries won’t be affected.
- Buy with a long-term mindset. Assume the market is going to close for five years after you buy your stocks.

In conclusion

You should know what kind of investments let you sleep well at night by reading, learning, and experimenting. Also, diversify your portfolio across multiple industries so that you don’t have, say, more than 25% in any sector. If you pick stable, quality businesses, your portfolio can only go up overtime.

CATEGORY

1. Bank Stocks
2. Dividend Stocks
3. Energy Stocks

4. Investing
5. Metals and Mining Stocks

TICKERS GLOBAL

1. NYSE:ENB (Enbridge Inc.)
2. NYSE:RY (Royal Bank of Canada)
3. NYSE:SU (Suncor Energy Inc.)
4. NYSE:TECK (Teck Resources Limited)
5. TSX:ENB (Enbridge Inc.)
6. TSX:FTS (Fortis Inc.)
7. TSX:MRU (Metro Inc.)
8. TSX:RY (Royal Bank of Canada)
9. TSX:SU (Suncor Energy Inc.)
10. TSX:TECK.B (Teck Resources Limited)
11. TSX:WPM (Wheaton Precious Metals Corp.)

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