Tips to Avoid Losing Money in the Stock Market

Description

Some people think investing in stocks is risky because of the volatility. In the short term, stock prices go up due to good news and down due to bad news. Only traders bet on short-term price movements for quick gains. However, if you're truly investing, you shouldn't expect the price of your security to go up quickly, but instead expect to hold on to the shares for at least three to five years.

The true risk is losing your money (i.e., your invested capital) permanently. Here are a few tips to prevent you from losing money.

Buy businesses, not stocks

First, view a stock as a business, one that's run and operated by real people. How does the business make money? Is the business overleveraged? Is the business profitable in most business cycles?

If you want a relatively stable investment, look for businesses that make money no matter what the market is doing and aren't overleveraged compared with its peers.

For example, most utilities are relatively stable investments. That's why utilities such as **Fortis Inc.** (TSX:FTS) and **Canadian Utilities Limited** (TSX:CU) have been able to continue increasing dividends for over 40 years.

Buy cheap, quality businesses

Another way to avoid losing money is to buy businesses at substantially lower prices than what they're worth. This principle can be applied to different types of investing, including value investing, dividend investing, and growth investing.

Essentially, we're looking for a margin of safety that's big enough for us to invest our money. The larger the margin of safety, the lower the risk.

One way to do this is to look for sector-wide or market-wide pullbacks of 15% or more, which usually mean there are some macro factors (such as interest rate movements and plummeting commodity prices) affecting the whole sector or market.

For value investing, even if a business has little or no growth, if its multiple is low enough, it might still warrant a buy.

Example

General Motors Company (TSX:GMM.U)(NYSE:GM) is a prime example of blending value and dividend investing. It's only priced at less than six times its earnings, and it's expected to grow its earnings by 10% this year.

Furthermore, it just hiked its dividend by 5.6% in the first quarter. Its annual payout is now US$1.52 per share, and it yields 5.1% at about US$29.60 per share.

Other than a margin of safety for its shares, investors can also enjoy a margin of safety for its dividend because its payout ratio is about 30% based on its 2015 earnings.

Conclusion

To avoid losing money investing, buy businesses at substantially lower prices than what they're worth. After all, the values of businesses don't change nearly as much as their stock prices. Dividend investing can further reduce risk because you get some of the profitability back in dividend paycheques.

Lastly, don't expect quick gains, but expect not to get your invested capital back for at least three to five years because we never know when the market will finally realize the value of the discounted businesses.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. NYSE:GM (General Motors Company)
2. TSX:CU (Canadian Utilities Limited)
3. TSX:FTS (Fortis Inc.)

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Date
2025/07/21
Date Created
2016/02/29
Author
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