What Self-Directed Investors Should Know: Part 2

Description

It can be exciting and rewarding to build and manage your own portfolio. However, self-directed investors should keep value and cost in mind to maximize every dollar they invest. They should also know what kind of account to use for investing to minimize taxes and maximize returns.

Value

Investors should never overpay for a stock. Doing so increases the risk and simultaneously lowers your returns. If you're buying a dividend stock, your initial yield will also be lower if you pay too much.

Look for stocks with a margin of safety. For example, if you want to invest in a technology company right now, **Apple Inc.** (NASDAQ:AAPL) may be a better choice than **Microsoft Corporation** (NASDAQ:MSFT) because Apple has a lower multiple of 11.3 compared to Microsoft's multiple of 19.1. In the medium term Microsoft is expected to grow its earnings by about 10%, while Apple is expected to grow its earnings by about 12%.

Which account to use

High-yield U.S. dividend stocks should be held in an RRSP, so there's no 15% withholding tax on the foreign dividend. However, be careful not to buy master limited partnerships (MLPs), such as **Blackstone Group LP** (NYSE:BX), because even if you buy it in an RRSP, rumour has it that there's a withholding tax of about 39% deducted from their distributions. Additionally, there may not be enough information to file taxes for MLPs.

Capital gains and Canadian-eligible dividends are favourably taxed in a non-registered account. However, if you have room in a TFSA, dividends kept there are tax free.

If you earn interests from bonds, GICs, or savings accounts, you might also consider placing them in a TFSA because interests are fully taxable based on your marginal tax rate.

Real estate investment trusts (REITs) such as **H&R Real Estate Investment Trust** (TSX:HR.UN) and **Artis Real Estate Investment Trust** (TSX:AX.UN) can be bought in a TFSA to avoid tax-reporting hassles because their distributions can consist of capital gains, foreign income, dividends, and return of capital.

However, the return of capital portion of REIT distributions reduces the cost basis and is tax deferred if the REIT is held in a non-registered account. Always check a REIT's corporate website to see what its distributions typically consist of to help you decide which account to hold it in.

Cost

Investors should keep costs in mind. Exchange-traded funds (ETFs) are a low-cost way to diversify as they typically cost around 0.5-1% per year compared to $10 per transaction to buy or sell a stock with your bank. However, other discount brokerages cost less. The ideal scenario is to keep costs low by trading less, only buying quality businesses when they're priced at a discount, and holding them forever.

Conclusion

The price is what you pay and the value is what you get. So, never overpay for any company. In fact, to improve returns, investors should aim to buy companies with a margin of safety. If it's a really high-quality company, pay at most a fair value for it.

It's good to know which accounts you should use to hold assets to minimize taxes and maximize your gains. Investors should use TFSAs, RRSPs, RESPs, and non-registered accounts appropriately for that purpose.

Lastly, investors should aim to reduce costs by trading less. And consider low-cost ETFs as a way to diversify.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. NASDAQ:AAPL (Apple Inc.)
2. NASDAQ:MSFT (Microsoft Corporation)
3. NYSE:BX (The Blackstone Group L.P.)
4. TSX:AX.UN (Artis Real Estate Investment Trust)
5. TSX:HR.UN (H&R Real Estate Investment Trust)

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