# Investors: It’s Okay to Break These 3 Common Investing Rules

## Description

The world of investing is a complicated place. I’d say just about every serious investor can agree with that.

And yet investing constantly gets reduced to a number of one-liners and rules of thumb. Quotes from Warren Buffett are repeated ad nauseam, often by people who have barely given the quote a second thought.

Investors can have good success following the rules quoted by the likes of Buffett, but I believe the investors who selectively ignore at least some them are poised to do even better. After all, Warren Buffett posted his best results back in the 1950s and 1960s after picking the cheapest stocks he could find without a second thought of quality. In effect, young Buffett broke all of older Buffett’s rules and still did pretty well.

Here are three common investing rules that successful investors break all the time.



**Don’t chase yield**

Every dividend investor knows about the danger of buying high-yield stocks. If the dividend gets cut, the share price usually collapses with it.

But that’s not always the case. Back in January, I called **Dream Office Real Estate Investment Trst** ( TSX:D.UN) the cheapest stock in Canada, urging investors to take advantage of the massive gap between the share price and the net asset value. Shares were trading at less than 45% of the net asset value while paying a dividend north of 15%.

It was obvious at that point that the 15% dividend wasn’t safe. The company confirmed my fears less than a month later when it announced a 33% reduction in the dividend.

And yet shares rallied hard on the news, surging from $15 to $18 each by the end of that trading day. A few months later shares are $20 each–a nice return from when I wrote about it.

At a certain point, the dividend stops mattering for stocks that were previously all about the yield. These stocks become value plays. A dividend cut gets priced in before it happens.

Additionally, there are stocks that struggle because investors fear a dividend cut that never materializes. These stocks inevitably recover, giving investors a nice capital gain to go along with an outsized yield.

**Avoid penny stocks**

Many investors steal a page from mutual funds and avoid stocks trading below $5 per share, which many argue is the new definition of a penny stock.

I understand that reasoning. Canada has its share of stocks that are nothing but a few assets on a balance sheet and the hopes and dreams of a management team that's often paid too much for the value delivered. Many of these companies are in the resource sector.

Investors need to remember that the price per share is less important than the underlying value per share. As long as a stock gives an investor a compelling value proposition, it doesn't matter if the share price is $1 or $10.

Most penny stocks are bad news. The ones that aren't offer enough potential to make that whole part of the market interesting.

**Avoid price-to-earnings ratios**

**Extendicare Inc.** (TSX:EXE), one of my largest holdings, currently trades at a price-to-earnings ratio of 48.7. The stock market might be expensive overall, but that's still a huge price to pay, at least on the surface.



Investors have to dig deeper than just using price-to-earnings ratios. Most of Extendicare's assets consist of expensive retirement homes, which are slowly written off over time. This creates huge amounts of depreciation, a charge which affects profits.

Instead, the company uses adjusted funds from operations (AFFO) as its chief earnings gauge. AFFO came in at $0.51 per share in 2015, which puts shares at 18.2 times earnings. And 2016 is projected to be even better as new retirement homes acquired in 2015 add to the bottom line. Projections are for AFFO to come in between $0.75 and $0.80 per share.

At the bottom end of that range Extendicare shares trade for just over 12 times earnings. Suddenly, a company that looked very expensive at first glance looks cheap, especially considering the long-term outlook for assisted-living facilities.

**CATEGORY**

1. Dividend Stocks
2. Investing

**TICKERS GLOBAL**

1. TSX:D.UN (Dream Office Real Estate Investment Trust)
2. TSX:EXE (Extendicare Inc.)

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**Date**
2025/07/07

**Date Created**
2016/05/09
**Author**
nelsonpsmith