



Investors: Protect Your Portfolio With These 3 Easy Steps

Description

After a run-up of some 25% since lows set in January, many investors are starting to feel that a correction in the **TSX Composite Index** is near.

They point to many different factors that could trigger a downturn. Alberta's economy is still struggling and is likely to continue to do so unless oil goes higher. Valuations are stretched among many blue-chip stocks, as investors greedy for yield pay up for what they view as quality. And the housing market still looms large. A piercing of the bubble could lead to widespread panic.

Nobody knows when the next correction will be, which is why it's prudent for investors to take steps to protect their portfolio today. Here are three easy steps investors can take to minimize their risk.

Increase bond allocation

I know of too many investors who have 100% of their assets in equities, confident they have the risk tolerance to handle any crash.

That might be true, but these investors are missing an important hidden benefit of bonds. When stocks get hammered, investors move into the fixed-income market, which often sees prices increase. This inverse reaction is the main reason for having bonds in a portfolio.

The important part is what happens next. Investors with a healthy bond portfolio can then sell those bonds at a gain and move the cash into undervalued stocks. Bonds provide the cash needed to go shopping during market crashes.

The easiest way for investors to get exposure to the bond market is through Canada's largest bond ETF, **iShares DEX Universe Bond Index Fund** ([TSX:XBB](#)), which holds more than 1,100 different corporate, provincial, and federal bonds. This ETF yields 2.7%.

Cherry pick cheap stocks

When times have been bad, investors have traditionally moved into utilities. And what better utility than **Fortis Inc.**

([TSX:FTS](#))?

But perhaps this time truly could be different. Fortis shares trade at \$43.07 today, which is more than 20 times projected 2016 earnings. That's an expensive valuation.

Fortis has also been taking on substantial amounts of debt without much in additional earnings to show for it. Including preferred shares, Fortis owes approximately \$13 billion to creditors compared to \$7.3 billion at the end of 2012; it also issued approximately 90 million more shares. And yet core earnings only increased from \$362 million to \$589 million.

Earnings should increase again in 2017 as the company gets a full year of its new acquisition in the United States added to the bottom line. Still, the fact remains that returns on invested capital won't be as lucrative as before because of low interest rates and competition among providers.

Instead, investors can look to cheaper stocks that are out of favour, like **TransAlta Corporation** ([TSX:TA](#))([NYSE:TAC](#)). Yes, I realize Alberta's largest power producer has problems, but shares are incredibly cheap on a number of different metrics, including free cash flow and book value.

I'm more confident in TransAlta delivering satisfactory returns going forward than Fortis, even though I'd be the first to admit the latter has fewer problems.

Use stop losses

Many investors don't want to hit the sell button just yet, nervous they'll miss out on another uptrend.

The solution is simple.

Instead of selling now and moving into cash, use a trailing stop loss. This will allow investors to protect on the downside while still taking part in any gains.

The tricky part about stop losses is where to set them; 5% below the market price is a popular choice, but we've all seen stocks decline 5% only to shoot up to new highs just a few weeks later. Perhaps 10% is the better option.

Take prudent steps today

The time to protect a portfolio is today, when the market is reaching new highs. It'll be too late once stocks start to really decline. It might seem a little silly when things are going so well, but trust me. You'll feel better about it once stocks do correct.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. NYSE:TAC (TransAlta Corporation)
2. TSX:FTS (Fortis Inc.)
3. TSX:TA (TransAlta Corporation)

4. TSX:XBB (iShares Core Canadian Universe Bond Index ETF)

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