6 Ways to Protect Your Stock Portfolio From Downside

Description

There are multiple ways to protect the downside of your stock portfolio, including investing in quality and stable businesses, buying at fair to discounted valuations, buying big-dividend stocks, aiming to invest for the long term, and always having some cash on hand to cushion the volatility.

Invest in quality and stable businesses

When searching for a quality and stable business, you can start by looking at where you pay recurring fees for a product or service. For example, you might have an internet or cell phone plan with one of the Big Three telecom companies, such as **Telus Corporation** (TSX:T)(NYSE:TU), that you pay monthly fees for.

It turns out that Telus has an S&P credit rating of BBB+, which indicates the telecom has good credit quality and has the ability to repay its debt. In the medium term, Telus is expected to grow its earnings per share at about 5-6% per year.

Quality and stable businesses tend to remain profitable even in harsh markets. So, investing in them helps protect the downside of your investments.

Invest in big-dividend stocks that grow their dividends

At $42 Telus pays a relatively big dividend of nearly 4.4%. (The **iShares S&P/TSX 60 Index Fund**, which is representative of the Canadian market, yields only 2.8%.)

Telus has increased its dividend for 12 consecutive years at a five-year compound annual growth rate of 10.9%. Most importantly, the company foresees increasing its dividend per share by 7-10% per year through 2019.

Telus has already increased its dividend from $0.44 to $0.46 per share this year. If it increases its dividend per share (DPS) by another two cents in December, the company will have increased its DPS by 9% this year.

Dividends help reduce the downside of your investments because you get a positive return from dividends no matter if the stock price goes up or down.

Buy at fair to discounted valuations

Since 2011 Telus has only traded three times at a price-to-earnings ratio (P/E) of about 15. At $42 Telus trades at a P/E of 15.9, which is within its fair-value range.

If Telus trades at a P/E of 15 or lower, it'll be a better bargain. Using the estimated 2016 earnings, a P/E of 15 implies $40 per share.

The lower the valuation you buy stocks at, the more downside protection you have.

Invest for the long term

When you aim to invest for decades instead of for a month or a year, you increase your probability of getting positive returns. Quality businesses have a better chance of surviving harsh times and coming out stronger afterward. So, having a long-term investment horizon reduces the downside of your quality investments.

Diversification

Instead of buying just one quality and stable company, invest in a portfolio of them. The number of stocks you hold is up to you, but it's generally accepted that one should hold at least 12 stocks from different sectors to be sufficiently diversified.

Then again, you should be comfortable with what you're holding. If you don't understand mining stocks at all, for example, there's no need to buy them in order to be diversified.

Besides, mining stocks don't fit the "stable businesses" category. Investors buy them for different reasons, such as for explosive gains during booming periods.

Cash

Having cash on hand will be handy for when you see quality companies priced at discounted valuations. Another important role cash plays is reducing the downside and volatility of your portfolio. In a down market, cash is king.

CATEGORY

1. Dividend Stocks
2. Investing

POST TAG

1. Editor's Choice

TICKERS GLOBAL

1. NYSE:TU (TELUS)

2. TSX:T (TELUS)

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