How to Navigate the Stock Market With Caution

Description

Both the Canadian and U.S. stock markets are near all-time highs and trading at high valuations compared to recent history. Most investors might have forgotten about the last market crash in which even high-quality stocks, such as **Bank of Nova Scotia** (TSX:BNS)(NYSE:BNS), fell as much as 50% in five months.

Here are some tips you can employ to help you reduce your risk in the current market.

Hold more cash

You can opt to hold more cash. In a fairly valued market, you might hold 5% of your portfolio value in cash. As the market becomes more expensive, you might opt to hold 10% or even up to 20% in cash.

Cash can do wonders. First, it acts as a cushion to mitigate the impact of market crashes. Second, you can use it to buy stocks at great values during a crash.

If you work, you can hold off on investing new money to increase your cash position. Some investors might even feel the need to trim profits.

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caution

Rebalance your portfolio

Some investors review their portfolios every quarter or every year to see if rebalancing is needed. Rebalancing can help you increase your cash position.

If a holding becomes more than 5% of one's portfolio, some investors trim it. Other investors look for companies whose share prices have run ahead of their earnings. In other words, these investors consider selling some shares of companies which look overvalued.

Invest for value

Some people like to be fully invested because they want their hard-earned money to work hard for them. If you are this type of investor, try to invest in stocks that are priced below their intrinsic values.

You'll find that even when the market trades near its all-time high, there's still value to be found.

Empire Company Limited (TSX:EMP.A) looks cheap compared to its historical levels. It could turn out to be a great turnaround story, in which case the shares could trade 30% higher from the $17 per share level. Its dividend yield of roughly 2.4% will add to returns as well.

Invest for dividends

Consider investing in dividend stocks, which offer safe yields of 3-5% and grow their dividends at the 7-12% range. Even when the market crashes, and we know it will sometime in the future, these stocks can give you positive returns and rising income from their dividends.

Enbridge Inc. (TSX:ENB)(NYSE:ENB) fits the bill. After merging with Spectra Energy, it has become the largest energy infrastructure company in North America with an enterprise value of about $165 billion.

The fairly valued company yields north of 4% and plans to grow its dividend by 10-12% from 2017 to 2024 while paying out 50-60% of its available cash flow from operations.

Investor takeaway

As the market nears its all-time high, it'd be smart to hold a bigger percentage of cash, especially if you have a stock-heavy portfolio.

This way, you can take advantage of any market dips to invest in quality stocks at value prices. It'll only benefit you if such stocks offer safe, growing dividends.

CATEGORY

1. Dividend Stocks
2. Investing

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2. NYSE:ENB (Enbridge Inc.)
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