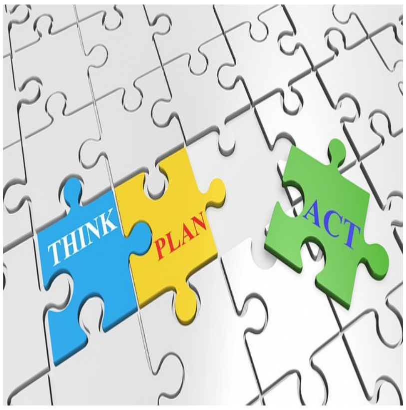

Why it's Not Enough to Buy the S&P/TSX Composite Index

Description

When Warren Buffett said that investors should stick with index funds, he didn't mean to buy just any fund and be done with it. It wouldn't do to only invest in a fund that replicates the **S&P/TSX Composite Index** (TSX:^OSTPX) (i.e., the Canadian market).

Here's why.

The index is concentrated in three sectors with an almost 69% weighting: financials (35.4%), energy (21.4%), and materials (12.1%). That's not nearly sufficiently diversified.

The index lacks greatly in consumer staples (4% of weighting), utilities (3%), information technology (3%), and healthcare (0.6%). Consumer staples and utilities have tended to deliver stable returns with reduced volatility, dividends, and dividend growth.

Information technology has been an area for tremendous growth. The healthcare sector in general benefits from the megatrend of an aging population.

So, it does not make sense to have little exposure to consumer staples, utilities, information technology, and healthcare.

If you are invested in the S&P/TSX Composite Index, you can increase your exposure to consumer staples, utilities, information technology, and healthcare by investing in other index funds or by investing in selective stocks in each sector.

Tech stocks for growth

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stock market index

In the information technology sector, we can look to the south of the border for a stock such as **Facebook Inc.** (NASDAQ:FB).

It still looks reasonably valued for double-digit growth potential, despite the shares trading near their alltime high.

Facebook will continue to benefit from the network effects of its growing global user base and the increasing spending on online and mobile advertising from its clients.

In Canada, we also have some technology stocks, including **Shopify Inc.** (TSX:SHOP)(NYSE:SHOP), which provides a cloud-based, multi-channel commerce platform targeted at small- and medium-sized businesses, and **Sierra Wireless, Inc.** (TSX:SW)(NASDAQ:SWIR) which is involved with the Internet of Things.

Both companies have had strong revenue growth. Shopify and Sierra Wireless have increased their revenues at a compound annual growth rate (CAGR) of 100% and 11.6%, respectively, in the last four years. Compare that to Facebook, which has increased its revenue at a CAGR of 52.6% in that period.

Ensure your portfolio is sufficiently diversified

If investors want to keep it really simple and invest in only one index fund, they can opt to invest in **SPDR S&P 500 ETF Trust** (NYSEARCA:SPY), which is well diversified.

The index fund seeks to replicate the performance of the S&P 500 Index, which is a market capitalization-weighted index of the 500 largest companies that are publicly traded in the U.S.

Currently, the index has weightings of about 22.9% in information technology, 14% in financials, 13.8% in healthcare, 12.3% in consumer discretionary, 10% in industrials, 9.2% in consumer staples, and 2.8-6.2% in energy, utilities, real estate, and materials.

This is much more diversified than investing in a fund that replicates the S&P/TSX Composite Index. In any case, if you're investing in funds, dollar-cost averaging over time is a good strategy. It takes away the emotions of greed and fear, which often deter investors from making the right investment decisions.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NASDAQ:META (Meta Platforms Inc.)
2. NASDAQ:SWIR (Sierra Wireless)
3. NYSE:SHOP (Shopify Inc.)
4. TSX:SHOP (Shopify Inc.)
5. TSX:SW (Sierra Wireless)

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