The Market Hits New Highs: What You Should Avoid

Description

It’s hard to believe that the Canadian market is hitting an all-time high. What should investors avoid? First, let’s look at some stocks that have done well before answering that question.

In the last 12 months, banks and utilities in general have done well and have typically outperformed or matched the market returns. Selective winners in the real estate sector also exist.

What stocks have done well?

The market, using **iShares S&P/TSX 60 Index Fund** (TSX:XIU) as a proxy, has delivered roughly 11.7% of total returns in last 12 months. **Royal Bank of Canada** (TSX:RY)(NYSE:RY), as the Canadian leading bank, did not disappoint. It has delivered roughly 24.2% of total returns in that period.

Fortis Inc. (TSX:FTS)(NYSE:FTS) also did its job well as a regulated utility — a low-risk investment. Its returns pretty much matched the market returns. This is impressive because we had interest rate hikes which were supposed to be a drag on “boring,” slow-growth dividend companies.

Higher interest rates also make it costlier for real estate investment trusts (REITs) such as **Canadian Apartment Properties REIT** (TSX:CAR.UN) and **Northview Apartment REIT** (TSX:NVU.UN) to do their businesses. However, both have outperformed the market. They have delivered returns of roughly 25% in the last 12 months.

Why have they done well?

One reason is investors have been buying at cheap valuations. Another is the companies' focus on quality assets.

A year ago, Fortis and Canadian Apartment Properties weren't exactly cheap, but they are quality businesses. In the case of the REIT, it is great, but it has always been too pricey for me to invest in.

I still have no interest in investing in the REIT today, because it's still expensive to me. At ~$34 per share, Canadian Apartment Properties trades at a multiple of ~18.8, while it's expected to match the growth of inflation. There's a chance that I will never get to own the stock, but that's all right, because there are many fish in the sea for stability and income.

Royal Bank was undervalued 12 months ago, while Northview was severely undervalued. Both are trading much closer to their fair valuations now. So, don't expect them to have a stellar performance again in the next 12 months. That said, there's nothing wrong with holding them for income.

Investor takeaway

The stock market hitting an all-time high isn't necessarily a cue to stop investing new money. However, investors should avoid chasing stocks that have had a great performance in the last little while — particularly the ones that have expanded their multiples and may be fully valued. After all, the more expensive multiple you pay for a stock, the lower expected returns and the higher risk you'll get.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. NYSE:FTS (Fortis Inc.)
2. NYSE:RY (Royal Bank of Canada)
3. TSX:CAR.UN (Canadian Apartment Properties Real Estate Investment Trust)
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