Why “Short Interest” Is a Risk to Avoid When it Comes to Picking RRSP Investments

Description

High-risk stocks add pizzazz to an investment portfolio, but they’re not the way to build an RRSP safely. Instead, try to set aside 10% of income after taxes and buy “blue -chip” stocks. An RRSP should be well built, like concrete in the foundation of your home. Add the frill after you have a solid base.

How do you assess investment risk? A beta above one is sometimes a useful metric. This means the asset tends to move up and down by larger amounts compared to a reference equity (like the TSX index).

But have you heard of short interest as another risk?

Short selling is when an investor borrows a stock with the intent of paying the value of that stock at a later date. An example of a short position would be borrowing a stock (from another investor or brokerage firm) at $10 per share, but actually paying for that asset at a later date when the value has dropped to, say, $9 per share. The short investor pockets $1 per share for the transaction. A short investor bets against the typical shareholder. This strategy is more common in speculative or over-valued stocks.

Where short interest is large

Klondex Mines Ltd. (TSX:KDX)(NYSE:KLDX) is a mining company with operations in Canada and the U.S. It closed last week on an impressive one-day increase of 7%. The company forecasts EPS of 0.13, which appears to be a fairly dramatic turnaround compared to 2017 when earnings were negative. The share price fell almost entirely in 2017 — a whopping 74% loss. Gold miners did not have a great year and were down modestly, but Klondex was an outlier.

Is the +7% one-day move enough to get you interested in Klondex? I would say no for one simple reason: the short interest is still sizable. According to the *Wall Street Journal*, ~10% of the one million shares traded daily are short positions, meaning that one in 10 trades are based on a negative view of

Klondex. You don't want this sort of thing to burn a hole in your retirement fund.

Hold off on Klondex until there are more signs of strength and more of the short investors have cleared away from this asset.

Two stocks where the short interest is small

Rogers Communications Inc. (TSX:RCI.B)(NYSE:RCI) had a spectacular run in 2017 and gave nearly all of its gains back with a protracted pullback. Short interest for Rogers is typically low. The current short float is 2%. Equally interesting: short positions have actually dropped 27% in two weeks. This is a strong sign for long investors that want to add telecom to their portfolios.

Rogers pays a decent dividend, currently 3.1% — income you can bank on for your retirement.

Suncor Energy Inc. (TSX:SU)(NYSE:SU) is one of the more dependable energy companies. Suncor's stock performance, and the energy sector in general, were some of the reasons the TSX was flat and underperformed compared to other indexes. Suncor had a sizable pullback to start 2018. Short interest for Suncor is virtually non-existent. EPS guidance is comparable to 2017, and the 2.75% dividend is safe. There are no frills here — it's another nice and easy pick for your RRSP.

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Date
2025/08/27
Date Created
2018/02/26
Author

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