Investors, Take Cover: 3 Reasons the Market Is Going Lower in 2018

Description

So far, 2018 has been wild. The TSX index is down roughly 4.8% year to date, which is not good.

At the end of January, investors were subjected to a nerve-racking couple of weeks when the market took a 7% plunge to $15,034, only to begin rising again. And yesterday the market tumbled again.

So what?

Do we just ignore that blip and this volatility? Or should we investigate this, so we can figure out what to expect?

Of course, we should investigate.

Here are the three reasons why I think that this volatility is foretelling more to come, and why 2018 is the year that the market will get hit.

Rising interest rates

Rising interest rates will take the market lower, as the discount rate in our valuation models will increase, thereby decreasing the present value of stocks.

And rising is exactly what interest rates are doing, with many expecting the Bank of Canada to increase rates four times this year to ultimately settle at 2%. That's up from well below 1% not too long ago.

The first hike to 1.25% was instituted back on January 17 off continued strong job numbers and strong economic growth outlook.

In this context, companies that will benefit from rising rates are a good bet, like **Industrial Alliance Insur. & Fin. Ser.** (TSX:IAG).

With a primary focus on the Canadian market, IAG stands to gain one of the most of its peer group from rising interest rates. The company has disclosed that a 10-basis-point increase in interest rates will impact net income by $15 million.

Canadian banks like **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD) are also a good bet. As interest rates rise, the spread between the rate the banks pay customers and the rate that the bank receives widens, bringing more profit to the bank's bottom line.

Since 1995, the TD's dividend has grown at an annualized rate of 11%, and the current dividend yield is an attractive 3.24%.

Heavily indebted consumer

Canadians have set records in terms of their household debt loads. At a 171% debt-to-income ratio, there is less room for increased consumer consumption to drive growth. Add to that rising interest rates, and, well, we have a double whammy.

So, with this in mind, stocks that are good buffers would be those that represent a needed or staples product, such as food and healthcare. Defensive stocks to weather the storm.

Empire Company Limited (TSX:EMP.A) is one such company that happens to have a renewed focus on efficiency, cost reduction, and delivering the customer a better offering that is designed to improve customer satisfaction, with good results so far.

Empire is a good bet in a difficult market.

Stretched valuations

With interest rates at record lows, we could have made an argument that higher multiples made sense, since the cost of capital for companies is lower and the discount rate would drive up valuations.

But as interest rates rise, this argument falls to pieces.

Investors should prepare for a market downturn.

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