How You Can Outperform the TSX in a Bear Market

Description

The global stock market correction at the beginning of February may have worried you, and you may be concerned that another market correction or, even worse, that a bear market might be coming soon.

If the possibility of a bear market worries you, you can prepare yourself for it. It's possible to outperform the TSX in a bear market.

Don't panic

First, it's important that you don't panic. Staying disciplined and keeping calm is the best attitude.

Unless you need your savings for a short-term expense, selling your stocks after their value has declined will materialize what was previously virtual losses. To make money with stocks, you need to buy low and sell high, not the other way around.

Keep your goals and your long-term outlook in mind. Don't panic when your stocks fall in value. If you are investing for your retirement in 30 years, your long investment horizon allows you to take more risks. You have time to regain what you have lost.

Moreover, if you look at markets performance over many years, you will see that they have always risen over the long term, despite short-term declines. To limit your losses, make sure your portfolio is well diversified.

If you are retired or close to retirement, you should secure a portion of your portfolio by investing in safer investments, like bonds.

Pick up bargains

Falling markets are actually an opportunity to take advantage of bargains in the market. Many stocks that were overvalued in a bull market begin to trade at more reasonable multiples.

Following Warren Buffett's advice to "be greedy when others are fearful" could be very profitable. Value investors like Buffett view beaten-up stocks as buying opportunities, because the valuations of good companies get hammered along with the poor companies when the whole market is plunging. Good companies are thus trading at more attractive valuations.

You can look at the P/E-to-growth (PEG) ratio to identify companies that are cheap relative to their future growth. The lower the PEG ratio, the more the stock may be undervalued given its earnings growth. A PEG ratio below one means a stock is below its fair value.

For instance, **National Bank of Canada** (TSX:NA) is a solid bank stock that trade at a low forward P/E of 11 and at a PEG (expected over five years) of 0.94, meaning it is cheap relative to its high growth prospects. National Bank's earnings are expected to grow at an average rate of 11.3% per year over the next five years.

Defend yourself by buying defensive stocks

Defensive or non-cyclical stocks are stocks that generally perform better than the overall market during bad times, since they are less volatile. These stocks usually provide a dividend that is sustainable and stable earnings, regardless of the state of the overall market.

Companies that produce or sell household non-durables, such as shampoo, toothpaste, and cleaning products, are considered as defensive because people will use these items regardless of the state of the economy.

Johnson & Johnson (NYSE:JNJ) does well in all kinds of markets and gives stability to your portfolio. With a beta of only 0.6, this stock falls less than the market when the latter is plunging. In 2008, when the TSX dropped by 35% and the S&P 500 plunged by 37%, Johnson & Johnson only fell by 7.6%.

Here in Canada, **Dollarama Inc.** (TSX:DOL) is a good defensive stock with a beta of only 0.4. People in general prefer to pay less for everyday items, and this is particularly true in bad times. So, this stock will perform well regardless of the economy. What is also interesting about Dollarama is its double-digit growth in revenue and earnings, so you benefit from high growth without a high risk.

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TICKERS GLOBAL

1. NYSE:JNJ (Johnson & Johnson)
2. TSX:DOL (Dollarama Inc.)
3. TSX:NA (National Bank of Canada)

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sbchateauneuf