2 Strategies to Beat the Market Over the Long Term

Description

If it weren't possible to beat the market over a long period of time by picking individual stocks, it would be wise to just own an ETF that replicates the whole market. While it isn't easy, you can beat the market over the long term if you buy the rights stocks at the right time. I propose here two strategies that can help you beat the market over many years.

Looking at beta

A stock's beta tells you how volatile a stock's price is relative to the overall market; that is, how the stock's price moves compared to the market.

A stock that has a beta of one will move with the market. Stocks that have a beta higher than one will move more than the market. If the general market is heading higher, these stocks should outperform. But if the market drops, high-beta stocks will probably plunge more.

For instance, **Canopy Growth Corp.** (TSX:WEED) should outperform in a bull market, because it has a very high beta of 3.73. This has been the case during the last years, as this pot stock has a five-year return 320% higher than the TSX.

A high-beta stock like Canopy Growth has a higher potential return than the market, but for a higher risk. During a bear market, Canopy Growth could plunge a lot more than the market.

Stocks that have a beta lower than one are less volatile than the market. Thus, these stocks will generally have lower returns than the market when it is rising, but they should outperform the market when it is plunging.

So, if you think that we are about to enter a bear market, you should instead buy low-beta stocks such as **Intact Financial Corporation** (TSX:IFC), which has a beta of only 0.35. This stock will generally fall less than the market when it is plunging, giving you some downside protection in a bear market. This has been the case in 2008, during which this insurance company's stock fell by 17%, while the market plunged by 35%.

You thus need to determine the market’s direction first to use the strategy based on beta efficiently.

Buying high-growth stocks

Unlike the strategy based on beta, you are going from down to up when you apply the high-growth approach for choosing stocks. That is, rather than predict the growth of the economy to choose your stocks, you examine the growth of the companies to determine which stocks are worth buying.

High-growth stocks are companies that have above-average growth prospects. Their earnings are increasing at a faster rate than the market.

As the TSX is expected to grow at an average annual rate of 12% over the next five years, you need to find stocks that have a growth rate higher than that.

To not overpay for high-growth stocks, you should buy stocks that are cheap relative to their growth prospects.

To do that, you can look at the price-to-earnings-to-growth (PEG) ratio. The PEG is calculated by dividing the P/E ratio by the average earnings-growth rate of the company. A stock that has a PEG ratio below one is trading at a discount relative to its growth.

Bombardier, Inc.’s (TSX:BBD.B) earnings are expected to grow at an average annual rate of 96.8% over the next five years, and the stock has a PEG of only 0.43. This means that this stock offers you high growth prospects for a low price, and it should outperform the market during the next years.

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2. TSX:IFC (Intact Financial Corporation)
3. TSX:WEED (Canopy Growth)

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