Enbridge Inc.: Is it Time to Catch This Falling Knife?

Description

By taking a contrarian position in a stock with considerable negative momentum, you must first realize that short-term pain will probably be realized for potential medium to long-term gains. It's a classic case of short-term pain for long-term gain (assuming you've got a sound thesis).

Unless you're a technical wizard with a four-leaf clover, your chances of catching the bottom on a battered stock are slim to none. There's no bell that rings when a stock hits bottom, so you'll need to expect near-term losses and be able to stomach them. That's why it's a smart idea to have a game plan before making any buys.

Patience is a key attribute for successful contrarian investors

Not only do you need a strong stomach, but you'll also need to be patient after you've decided to pull the trigger on a stock because you're confident enough in your thesis. While it's possible that a bounce back in shares of a battered stock can happen in the months or even days after your purchase, the reality is that your thesis may take a lot longer for the market to truly realize. Thus, you'll need a time frame in order to see your thesis come to fruition in the form of a rallying stock.

Strong hands are needed to catch a falling knife

It doesn't make sense to take a contrarian position in a stock like **Enbridge Inc.** (TSX:ENB)(NYSE:ENB) if you've got weak hands because you'll just end up getting hurt as the percentage losses quickly mount, eventually surpassing your maximum threshold of pain (your stop).

Moreover, stock turnarounds seldom happen the way you'd expect, even if your long-term thesis is sound. The unexpected happens, which could cause many investors to throw in the towel, and there could be a lot more downside than you originally expected. That's why it often pays major dividends to buy partial positions, expecting a stock to continue to drop, whereby you'll add to your position, lowering your cost basis and increasing your average yield.

With this in mind, you'll have stronger hands than that of many weak-handed investors jumping in and out of a rapidly falling stock in hopes of catching the perfect time to make a quick buck off a V-shaped rebound.

Of course, with a stock like Enbridge, many uncertainties stand to exacerbate further negative momentum, like the unfavourable and unexpected Minnesota ruling on the Line 3 replacement. This event caused shares to fall, and could be the start of a continued rally downward; however, those who truly believe in their thesis should stick around to enjoy a potential rainbow that usually follows the storm.

You'll need strong hands and a strong stomach in order to lock in Enbridge's ~7.2% dividend yield and potential bounce-back gains. Contrarian bets are seldom timely, so investors need to have patience in order to become a true contrarian investor.

Bottom line

When one chooses to catch a falling knife, one should expect pain. If you've got a firm contrarian mindset and a game plan going in, you'll lower your chances of getting impaled by the falling knife. However, you'll still stand to be nicked, so you've got to determine whether the potential reward is worth the pain you'll stand to realize.

Moreover, when it comes to stable high yielding stocks like Enbridge, the only way you'll lock in massive dividend yields is if you buy and hang on. If you sell, the only thing you'll lock in is a loss.

Stay hungry. Stay Foolish.

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Author

joefrenette