2 Poisonous Stocks to Get Rid of ASAP!

Description

One of the pitfalls of being a do-it-yourself investor is the many value traps that have been dispersed across the entire market. While Warren Buffett's contrarian investing approach is a fantastic way to obtain superior long-term results, beginners often misunderstand the whole concept of contrarian value investing, as some may fail to consider other important aspects when it comes to spotting hidden gems in the rough.

As such, many new investors may adopt a "cigar butt" investment approach when they think they're investing, much like the Oracle of Omaha himself! This approach could leave an investor's portfolio exposed to toxic stocks that could damage both near and long-term performance, especially if the reason for the downfall is the deterioration of a firm's long-term fundamentals.

Part of being an effective value investor means taking time to do the appropriate due diligence in order to recognize catalysts that could result in a scenario, whereby an investor may be willing to take a short-term hit in exchange for a high probability of long-term outperformance.

It's a classic case of no pain, no gain! If you've got yourself a value trap, however, it's all pain and probably no gain!

IGM Financial Inc. (TSX:IGM)

Canadians pay some of the highest mutual fund fees in the world. But what exactly are they paying for?

Well, the sad truth is that they're really not paying up for anything. In fact, on average, Canadians are paying obscene fees (+2% MERs) for poor performance.

How could this have happened?

A lack of performance reporting regulations has allowed mutual fund firms to report in a way that's difficult to comprehend for the average new investor, who likely understands little to nothing about financial securities.

Clients willing to participate in such funds are paying someone for their knowledge, after all, but the fact of the matter is that many of these clients really have no idea what they're paying for and what kind of performance they stand to get until longer-term underperformance becomes more apparent.

Fund performance expectations, the real cost of management fees, and "advisors" forced into a conflict-of-interest scenario have paved the way for an industry that's actually pretty shady. Approximately 80% of Canadian fund assets are based on commission-based accounts. That means 80% of advisors have had to deal with a conflict-of-interest scenario!

With regulators poised to step up to the plate to put an end to trailer fees and other conflict-of-interest inspiring compensation incentives, non-bank asset managers like IGM could experience a profound drop in their assets under management (AUM), as they're forced to communicate the sub-par performance and ridiculously expensive fees that come with such actively managed mutual funds.

As regulators become more proactive, IGM Financials' AUM will likely plunge over the next few years, and I suspect the stock will crater.

Alaris Royalty Corp. (TSX:AD)

Alaris smells like your run-of-the-mill value trap. The stock's artificially high 10% dividend yield should be a clue, but still, many income-conscious contrarians continue to look to the stock as a means of giving themselves a raise.

The firm collects royalties from private equity firms, which are then passed back to shareholders. Pretty simple, really.

Alaris' management does their homework to ensure that a company they're willing to partner with is in fact capable of paying back royalties throughout the duration of a partnership. While Alaris' partner-base is nicely diversified, it only takes a few bad eggs to spoil the basket. The basket being Alaris itself.

Another serious problem with investing in Alaris is that the company partners with a broad range of private firms that span many industries. I'd be more comfortable if Alaris had specialized within one sector of expertise, like tech or consumer products. To me, it appears that Alaris' management is a jack of all trades and master of none.

Investors still keen on the firm's 10% yield ought to research the solvency of each one of Alaris' partners. While the dividend is safe for now, all it will take is a few more delinquent partners to result in a dividend cut and a further plunge in shares of Alaris.

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1. TSX:AD.UN (Alaris Equity Partners Income Trust)
2. TSX:IGM (IGM Financial Inc.)

PARTNER-FEEDS

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