The Latest Superstition About Defensive Stocks May Have Some Truth to it

Description

Some investors have a strictly methodical approach to picking stocks. Others rely on a broker's advice or read articles that give suggestions for stock picks. And then there are those that like to go with their gut. One of the problems with investing by intuition is that this style leaves the door open for concepts like luck and superstition, which are rarely a match for experience and a calculator.

If you belong to the latter crowd of investors, you may want to hear about a worrying superstition that's doing the rounds. And for the rest of you, stick around: for once, an investing superstition seems to have some basis in fact.

A lesson from Japan?

If you like to keep an eye on world markets, you may have noticed that there is some discussion at the moment about the performance of the Nikkei. While the Japanese stock market has seen some turbulence of late, investors there remain bullish.

But what investors in the Nikkei index seem to be buying the most of are defensive stocks. While it's good news that stocks in Japan are still selling at high volumes, some analysts have pointed out that when defensives outperform on the Nikkei, a downturn often follows.

This observation has taken on almost mythic proportions — to the point that there is a persistent superstition that holds Japanese investors flocking towards food, drug, and retail stocks as a bad omen.

This was the case until the beginning of July when the Nikkei suddenly slumped on compacted news of falling Japanese business confidence and NAFTA concerns. This jolting slide seems to have proved the superstition right once again, though a further downturn may be around the corner.

What's the implication for the TSX index?

Investors typically navigate towards defensive stocks when there are market uncertainties. It makes sense to be invested in historically stable sectors when things are looking shaky. So, perhaps there is nothing particularly spooky about downturns following outperforming defensives.

Canadian investors may want to follow the Japanese lead and get into defensive stocks such as **Canadian Imperial Bank of Commerce** (TSX:CM)(NYSE:CM), which is currently great value for money and pays a +4% dividend. Other strategies include getting into gold, and buying up consumer defensives, such as the bigger retail companies. Energy companies are a favourite, too, though oil prices are the subject of much debate at the moment.

The bottom line

The take-home message here is that Canadian investing seems to be mirroring the Japanese style at the moment. Commentators eyeing outperforming defensive stocks on the Nikkei may well be right in suggesting that this behaviour seems to augur a coming downturn.

Likewise, a similar buying pattern in Canada may be a sign that an economic slowdown is on the way. If so, now would be a good time to pare away any dead wood from your portfolio and stay invested in stocks that can weather a storm. Those defensive stocks that are behind today’s worrying superstition? You might want to hold on to them.

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vhetherington