These 3 Words Could Cost Canadian Investors Millions

Description

They’re on everybody’s lips at the moment: three words that could put a permanent crimp in your investment portfolio. Hang around any online stock trading forum, or check the news for stock updates, and you’ll see them. Those words are “yield curve inversion.”

Read on to see what the fuss is about, and why a yield curve inversion could signal the beginning of the end of easy.

What is a yield curve inversion anyway?

A yield curve inversion sounds relatively harmless, but it has the potential to seriously mess up your portfolio. In simple terms, it refers to a market trend in the U.S. in which yields for long-term bonds flip and fall under yields for short-term bonds. While this sounds unbelievably dull and not particularly pertinent to Canadian stocks, the fact is that this inversion of the yield curve has closely preceded each of the last three recessions in the U.S.

The big deal at the moment is that the yield curve looks like it’s ready to flip. If banks in the U.S. decide to switch from fiscal tightening to easing, the yield is almost certain to invert, so concerned economic analysts are watching what the Federal Reserve does next.

When fear of slow growth overtakes fear of inflation, that’s when to start worrying. In short, watch for an increase in the federal funds rate, since this is likely to precede a yield curve inversion and precipitate a recession, making for a clearer and earlier marker.

Is anywhere safe?

Defensive stocks are the order of the day. The current front-runner is **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD). This is a very healthy stock today, and it’s reasonably valued on multiples if you ignore that it’s going for twice its book price. TD Bank has a high allowance for bad loans, which is why we’ve singled it out. Its fundamentals (apart from its P/B) are nice and low, and it pays a middling but stable dividend yield of 3.49%.

Canadian investors with less appetite for U.S. exposure should consider **Bank of Montreal** (TSX:BMO)(NYSE:BMO) instead. One of the best value Canadian banking stocks today, BMO has great multiples, a very healthy balance sheet, and pays a 3.69% dividend yield, making it ideal for TFSA and RRSP investors.

While TD Bank has a high tolerance for risk, a lot of its recent growth comes from U.S. expansion. Canadian investors should be aware of this exposure to the U.S. economy and perhaps consider BMO instead for its better value for money and stability in the domestic financials industry.

The bottom line

If you see that yield curve flip, it could signal the beginning of a downturn. However, analysts state that the lead time is variable: a downturn could happen anywhere between 18 and 36 months after an inversion. How the Fed reacts to a flipped yield curve is essential, so watch the news from our American cousins.

In the meantime, investors should know what they hold and hold what they know, cutting out any dead wood and getting deeper into defensive positions, while allowing for one's own appetite for risk. It's by no means too late to get defensive with your stocks, so perhaps now would be a good time to start looking into waterproofing that portfolio.

CATEGORY

1. Bank Stocks
2. Dividend Stocks
3. Investing
4. Stocks for Beginners

POST TAG

1. Editor's Choice

TICKERS GLOBAL

1. NYSE:BMO (Bank of Montreal)
2. NYSE:TD (The Toronto-Dominion Bank)
3. TSX:BMO (Bank Of Montreal)
4. TSX:TD (The Toronto-Dominion Bank)

PARTNER-FEEDS

1. Msn
2. Newscred
3. Sharewise
4. Yahoo CA

Category

1. Bank Stocks

2. Dividend Stocks
3. Investing
4. Stocks for Beginners

Tags

1. Editor's Choice

Date
2025/08/25
Date Created
2018/07/30
Author
vhetherington