Is It Better to Invest in Quality Stocks or Bargain Stocks?

Description

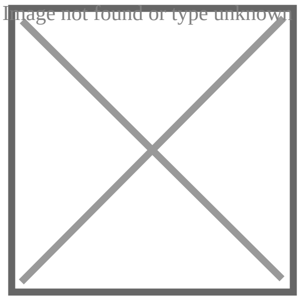
Both **Intact Financial** (TSX:IFC) and **Manulife Financial** (TSX:MFC)(NYSE:MFC) are in the insurance industry. However, the former is viewed as a higher-quality name.

One proof is that the market often prices Intact stock at a higher multiple than the stock of Manulife. For example, Intact's eight-year normal price-to-earnings (P/E) multiple is 16, while Manulife's is 12.8.

Another sign of Intact's quality is that its five-year return on equity is about 12%, compared to Manulife's 9%. As well, Intact's recent net margin was 6.8%, which is higher than Manulife's 4.2%.

I must point out that from an investment-to-investment comparison, Intact is a higher-quality company. However, it's not really fair to compare the two like this because Intact is in the property and casualty industry, while Manulife is in the life and health insurance industry. A fairer comparison would be between Manulife and **Sun Life Financial**.

Image not found or type unknown



Is it better to invest in quality stocks or bargain stocks?

Earlier this year, I'd debated if I should invest in Intact or Manulife. Specifically, I considered Intact when it was trading at a good valuation at below $95 per share. In about three months, the quality stock has popped +14% to a fairer valuation, while Manulife remains a bargain stock.

At about $24 per share as of writing, Manulife trades at a P/E of about 9.4, while it's estimated to grow its earnings per share (EPS) by about 11% per year for the next three to five years.

What about the valuation of Intact? At about $108 per share as of writing, the stock trades at a P/E of about 18.8 and is estimated to grow its EPS by about 15% per year for the next three to five years. So, Intact is still a decent value, but Manulife is an even bigger bargain.

I've explained previously why Manulife may be priced at a bargain. Stocks that trade at a bargain can remain cheap for an extended period of time. So, investors need to be patient.

It never hurts to focus on quality businesses. However, investors need to be cognizant of how much they pay. If you pay a reasonable valuation for a quality stock, you can get steady, above-average returns. However, if you overpay for a quality company, it could take some time for the company's earnings to catch up, and you'll likely get sub-par near-term returns as a result.

Bargain stocks can deliver higher returns than quality stocks bought at a reasonable valuation. However, it could take time for bargain stocks' multiples to revert to the norm.

That's why an investment in Intact five years ago delivered returns of about 11.2% per year, while an investment in Manulife delivered about 13.2%. I should mention that the actual EPS growth rates affect how well stocks perform as well. Generally, the higher the growth rate, the better.

Investor takeaway

The best scenario is to buy quality businesses at bargain prices. However, these opportunities don't come very often. It's a personal investment choice to choose between paying higher multiples for quality businesses or buying bargain stocks to aim for higher returns.

In my opinion, purchasing Manulife today over Intact should deliver higher returns for a three- to five-year investment.

CATEGORY

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

TICKERS GLOBAL

1. NYSE:MFC (Manulife Financial Corporation)
2. TSX:IFC (Intact Financial Corporation)
3. TSX:MFC (Manulife Financial Corporation)

PARTNER-FEEDS

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

Category

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

Date
2025/09/11
Date Created
2018/09/22
Author
kayng