The TSX Index Is Down 5% in 2018: 2 Reasons New Investors Should Roll With Blue-Chip Stocks Over ETFs or Index Funds

Description

The S&P/TSX Composite Index dropped another 200 points on October 11. This pushed the index down 5.5% for 2018. It also put the index into negative territory year over year.

Back in March, I'd discussed some of the perils of passive investing for modern investors. Legendary investor Carl Icahn called passive investing a "dangerous bubble" earlier this year, as ETFs and index funds had exploded on the back of ballooning asset valuations since the financial crisis. *Bloomberg Intelligence* reported that ETFs recorded over $690 billion in inflows in 2017 compared to $45 billion in outflows for actively managed funds.

These type of investment vehicles are often pitched to new investors as a slick alternative to managing your own portfolio or putting their money into an actively managed fund. Today, I want to go over two reasons investors should choose blue chips, like Canadian bank stocks, over a TSX-focused ETF or index fund going forward.

Bank stocks are the best a strong Canadian financial sector has to offer

One of the main attractions for passive-investment vehicles, in addition to the "set it and forget it!" appeal, is the diversification offered by tracking an entire index. This is another downside for the TSX, which is heavily weighted in an energy sector that has struggled since the 2014-2015 oil price shocks. Financials are also heavily weighted on the TSX, and this is where many investors just starting out have chosen to focus their attention.

Royal Bank of Canada (TSX:RY)(NYSE:RY) stock fell 1.99% on October 11. This pushed shares into negative territory over the past year. Royal Bank has performed well over the past five years, as shares have climbed over 40% in this span. The bank is well diversified and is the largest financial institution in Canada by total assets.

Better returns and dividend payouts

A Canadian investor who'd bought into a TSX-focused ETF at this time in 2017 will be looking at negative returns today. They will have paid a small fee to boot. Investors who have the time and the patience to manage their own portfolios should question the long-term strategy of passive investment in an ETF or an index fund. For example, **Vanguard FTSE Canada All CAP ETF** (TSX:VCN) has returned 6.6% over a five-year period as of close on October 11.

Bank of Nova Scotia (TSX:BNS)(NYSE:BNS), the worst-performing bank stock over that same period, has posted returns of 23%. Scotiabank also offers a quarterly dividend of $0.82 per share, representing a 4.4% dividend yield. The combination of capital growth and solid, consistent income makes bank stocks more reliable and ultimately more stable alternatives to ETFs or index funds.

Investors may choose to re-evaluate their portfolios after the recent global rout. Passive investing can still be a justifiable strategy for some, but for those focused on Canadian assets, domestic bank stocks have been a far better option in the post-crisis years.

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aocallaghan