The Number 1 Investing Rule Canadians Should Follow

Description

Monday's earnings provided a good example of a stock type which Canadian investors should never buy into. Here's why you should avoid it and two stocks you should consider instead.

Investors reacted negatively to **The Stars Group** (TSX:TSGI)(NASDAQ:TSG) earnings on Monday, but the stock rebounded on Tuesday's market open. The gaming corporation reported earnings of $0.62 per share for Q2 2019, which was higher than the analysts' estimates of $0.59.

The company also announced positive free cash flows and a continued focus on reducing debt. The higher free cash flows and reduced debt are a sign that the stock price may appreciate in the next year – but, it's a gamble.

The top reason to avoid the Stars Group: The stock doesn't issue a dividend.

It's true – consumer cyclicals might not be the best performer amidst concerns of a looming recession. Moreover, the stock's price has fallen over 50% in the past 52 weeks.

While it may be time for a rebound, there may be better opportunities on the **Toronto Stock Exchange** (TSX).

Tell the Stars Group: no dividend, no cash

Founded in 2004, the Stars Group is an online gaming and betting corporation operating in Europe, Australia, and North America. The company also hosts live poker tours in Europe, Latin America, and Asia.

The Stars Group would be a buy suggestion if it offered a dividend. Given the over 50% loss in market value over the past year, the stock should be offering shareholders periodic returns to compensate them for the liquidity risk.

Without a dividend yield to guarantee some performance, smart investors can't be expected to buy shares.

Although Stars maintains a positive levered free cash flow – which amounted to $380.16 million in 2018 – the company, like its customers, takes on a significant amount of risk in the form of debt.

Higher debt levels tend to drive shareholders away from stocks. Meanwhile, Stars Group's debt reduction efforts, although positive, do not necessarily guarantee better stock price performance next year.

Insurance stocks are set to fly on the TSX

Investors with a penchant for gambling could not do better than Stars. Serious investors, however, should invest in Canadian insurance stocks like **Power Corporation of Canada** (TSX:POW) and **Manulife Financial** (TSX:MFC)(NYSE:MFC).

These insurance companies are underpriced with earnings per share at over 10% of the market price and dividend yields at around 5%. Manulife has even increased revenues available for investment by over 25% in the past year, foreshadowing future earnings growth.

Both stocks are maintaining their current levels of debt, but Manulife's obligations relative to operating cash flow are lower. Manulife's debt is only 1.07 times its operating cash flow of $19 billion.

Meanwhile, Power maintains a similar level of debt at over $17.62 billion – which is 2.63 times its $7 billion cash flows.

Foolish takeaway

Tax-Free Savings Account (TFSA) and Registered Retirement Savings Plan (RRSP) investors should avoid gambling on stocks that don't offer a dividend. Instead, look for dividend stocks with strong financials that provide a guaranteed return.

At best, capital gain expectations are a gamble, especially in the middle of a trade war.

Dividend earning stocks with positive free cash flows might surprise investors with up to 50% capital gains in the next 12 months – in addition to the enticing dividend.

In fact, Manulife financial is likely headed for a capital gain of just that level, given its low levels of debt relative to cash flow.

Smart investors searching for high TFSA or RRSP returns should only consider dividend stocks. Don't waste time on risky investments that merely suggest the possibility of capital gains. There are more profitable opportunities in dividend issuing equities.

CATEGORY

1. Dividend Stocks
2. Investing
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TICKERS GLOBAL

1. NYSE:MFC (Manulife Financial Corporation)
2. TSX:MFC (Manulife Financial Corporation)
3. TSX:POW (Power Corporation of Canada)

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