TFSA Investors: Don’t Make This Costly Mistake

Description

If a stock appears to be undervalued on the markets, there’s usually some reason behind it. Bank stocks, for instance, have been lagging for much of the year as concerns about the economy have weighed down what should otherwise be solid investments.

That’s where it’s important for TFSA investors to always consider all the risks facing a company, whether or not the company has control over them.

One particularly risky area that investors may want to steer clear of is stocks that are exposed to the risk of falling commodity prices. The oil and gas industry is a great example of this, as there are many good, quality stocks out there that investors simply don’t want to have anything to do with.

Cenovus Energy Inc (TSX:CVE)(NYSE:CVE) is a great example of that. The stock is highly correlated with the price of oil and how the commodity does can have a significant impact on the stock itself.

Earlier this year, when we saw oil prices suddenly spike, Cenovus was able to benefit from stronger prices. Although it was ultimately short-lived, it reinforced just how much exposure Cenovus investors face with low commodity prices.

While it may seem low risk today given that oil prices have been relatively stable this year, all it takes is one bad report showing supply levels are too high or demand is too low that could send oil prices into a tailspin, again. It’s a risk that Cenovus investors have become all too familiar with.

And investors shouldn’t forget that though the levels are as high as they are, it’s also largely to do with production cuts. If that’s ultimately curbed, oil prices could see the floor pulled right from underneath them, resulting in a lower price. That’s where OPEC is another risk factor for Cenovus because of the power in determining the strength of oil prices.

Investors normally hope that a company that has strong fundamentals and a good, profitable business should be enough to make a stock a good investment; however, the reality is that it isn't. Although Cenovus has been able to record a profit for three straight quarters, it hasn't been enough to keep the stock price from losing momentum as oil prices have fallen.

Even though the company is trading below its book value, it's indicative of the level of risk that investors perceive with the industry today. That's why stocks that are dependent on commodity prices may not be ideal for TFSA investors looking to minimize their level of risk.

Bottom line

When choosing stock for a TFSA, investors should always consider all the risks facing the company, which means going beyond just the internal and looking at ratios and financial statements.

The challenges facing the industry can sometimes be more significant than company-specific risks, and ignoring them could be perilous for investors who decide to buy shares of companies that are dependent on a high commodity price for success.

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1. Dividend Stocks
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