How to Invest in Stocks

Description

So, you've decided to become a part-owner in businesses and share their profits and risks. You may have been attracted to stock investing by stories like **Tesla**. The stock just doubled investors' money in merely a few months.

However, let me be crystal clear that this kind of success story is rare. You can indeed double or even triple your money in stocks (if you pick the right ones), but oftentimes, it takes way longer than that.

Keep in mind that each stock comes with its unique risks and can go down as well as up. When there's bad news that relates to the company in question (whether it's macro or company specific), the stock will fall. Stock declines due to deterioration of company fundamentals are the worst kind of declines.

Before making your first investments, you should decide whether you want to be a passive or active investor.

Passive investing: Mutual funds, ETFs, and robo-advisors

If you're just starting out, it's often a better approach to go with passive investing via mutual funds or exchange-traded funds (ETFs), the latter of which has become more popular due to their low-cost nature.

For mutual funds and ETFs, you can select the areas you want to invest in, instead of having to pick individual stocks successfully.

For example, you may be interested in a cybersecurity ETF for growth as data — personal and corporate — are hacked into and compromised every day, and that problem is not getting any better.

Instead of investing in a single stock like **BlackBerry**, it'll be much less risky and volatile to invest in a fund like the **Evolve Cyber Security Index Fund**, which has the ticker CYBR. The ETF currently has 38 holdings, including a 74% weight in the U.S. and a top holding from Israel. How's that for diversification outside Canada? (Many Canadians are concentrating too much of their investments at home.)

If you don't have time or the interest to research what to invest in, you might consider going with a truly passive and diversified approach — robo-advisors. They first came to the scene in Canada around 2014.

According to your risk tolerance and financial goals, robo-advisors invest for you and automatically re-balance your portfolio periodically across ETFs (in bonds, emerging markets, and U.S., Canadian, or other stocks) for a management fee of about 0.5%. Moreover, some don't require a minimum investment amount, which means you can invest in as little as $1!

Active investing: Stocks

Stock picking can be incredibly rewarding and satisfying if you identify great businesses, like **Constellation Software** (TSX:CSU), and invest in them.

An investment in the tech stock merely five years ago has been a four-bagger — essentially growing a $10,000 investment into more than $40,000 for total returns of about 32% per year.

From its website, the company states that it acquires, manages and builds market-leading software businesses that develop specialized, mission-critical software solutions to address the specific needs of its particular industries.

It has been doing an extraordinary job, which is reflected in its high returns on equity (ROE). It has had ROE in the double-digit percentages every year since 2009. That was when the last financial crisis was still in great effect!

Its five-year ROE was a whopping 52%. Notably, its returns on assets (ROA) were also good with a five-year ROA of 11%.

These high returns suggest that management has been making the correct decisions, including in acquisitions and the prices (i.e., valuations) paid for the acquisitions, and managing the businesses well.

Although the tech company offers a puny yield of only 0.4%, it is a formidable growth stock that investors can consider buying on meaningful dips of 10-20%.

Investor takeaway

Investing can be as simple or as involved as you make it. You can go with ETFs or robo-advising for passive investing or you can actively choose wonderful businesses carefully and buy them at good valuations, as Warren Buffett does.

Both the passive- and active-investing paths can be rewarding financially, because it's time in the market that allows for compounding to work its magic.

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1. Editor's Choice

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1. TSX:CSU (Constellation Software Inc.)

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