Toxic Stocks: How to Fix Your Portfolio in 3 Steps

Description

A new type of market is emerging. Investors are being advised not to time the bottom. But how should long-term investors react to a period of intense market instability? Here are three suggestions.

Step one: Don't trust that index

Indexes are a great way to gain instant diversification while tracking the market. Except that there are some areas that you might not want to be diversified into right now. And the market is volatile and not to be trusted. Yes, the TSX Composite Index has rallied significantly in the last four weeks. But look how much it's lost year on year.

This is a stock-picker's market, therefore. Cannabis investors might recognize the territory. When a sector is of mixed quality, only a few outperforming names are worth buying. The whole market looks like this right now. Investors should watch the tickers closely and see which names are perming the strongest.

Step two: Manage your oil exposure

Trimming oil exposure in your portfolio makes sense right now. It's a big reason to get out of indexes, since it's hard to tell how many toxic oil names your asset manager isn't telling you about. But going after oil stocks in particular is a smart move right now, even if you're not invested in a catch-all fund.

Is there a contrarian case for buying battered oil stocks? Yes, there is, but it relies on a recovery stemming from either of two scenarios. In the first scenario, oil survives the headwinds of a competing and increasingly cost-effective green power industry. Oil, like any other natural commodity, is of limited supply after all. It's not like the wind, or solar energy. Eventually, if the sector survives, oil prices could recover.

In the second scenario, several big names in the oil sector could figure out how to convert oil fields for hydrogen sequestration. This is already underway and could see hydrocarbon producers turn into entirely different businesses.

Step three: Mix growth into your dividend stock holdings

Investors should consider **Polaris Infrastructure**, which packs a meaty dividend yield of 7% with strong long-term growth potential. This is a great play for the green economy along with all of the disruptive growth of that sector. Importantly, Polaris provides investors with access to geothermal and hydroelectric energy exposure. A 65% payout ratio leaves room for dividend growth, which is especially key right now.

But investors should manage their expectations right now. This means cutting projected EPS and even making allowances for dividends to be suspended. Add names like Polaris to your watch list and figure out where your entry points are. How much do you want to pay for those shares?

Then, rather than buying in bulk, cut up your position into pieces. Buy in stages as the market deteriorates, and your position will come at a lower cost. This allows for capital risk reduction while also building a position over the duration of a market selloff. In the meantime, make use of market rallies to trim names that haven't performed to your portfolio's key targets.

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