TSX Investors: Buy Defensive Stocks As the Pandemic Deepens

Description

Prime Minister Justin Trudeau has announced that the $500-per-week Canada Emergency Response Benefit (CERB) initiative is to be extended by a further eight weeks. But what does this mean for investors, and could it have a knock-on effect on the **TSX**?

Let's explore some surprising hidden dangers in the markets as the pandemic continues to weigh on the economy.

Balancing social necessity with economic risk

A combination of zero-commission brokers – see the Robin Hood craze south of the border – with rising mass unemployment has arguably helped fan the fires of high-risk day trading. To say that there's a disconnect between the markets and the economy at the moment is an understatement. But it's possible that the rise in hazardous, zero-commission trades could be helping to drive this disconnect.

Pundits have expressed surprise at how resilient the markets are. It's a dangerous situation, though, with investors overheating the markets by snapping up cheap stocks that have been trashed by the pandemic.

It's not beyond the realms of possibility that an extra injection of stimulus measures either side of the border could actually help to overheat the markets. Ultimately, a liquidity injection could even help fuel another market crash.

As billionaire Leon Cooperman told CNBC on Monday, "Let them buy and trade. From my experience, this kind of stuff will end in tears." Referring to what he called the "Robin Hood markets," Cooperman drew attention to the flawed logic of certain asset types – such as airline stocks – having higher valuations than they did before the pandemic. Such assets have rocketed due to perceived value opportunities.

Buy dividend “forever stocks” to cover all eventualities

Investors should be cautious and discerning when it comes to cheap stocks. But there’s another key consideration when it comes to CERB payments: the CRA clawback. CERB recipients will have to set aside enough to cover tax on this temporary income.

Meanwhile, investors may also think about offsetting that tax clawback by increasing their Tax-Free Savings Account (TFSA) holdings.

Indeed, stock investors should be aware that the CERB payments are being extended as a sign that things will be rough for a while longer. Names like **CN Rail** and **BCE** combine reliable yields with wide-moat business operations and satisfy a defensive strategy.

They’re tailor-made for the casual buy-and-forget TFSA investor. Both names are thoroughly diversified and pay 1.9% and 5.7% dividend yields, respectively.

Investors should be aiming for a “3D” portfolio, composed of defensive, diversified dividends. For the casual TFSA investor to the retiree feathering a nest of income stocks, this long-term strategy sidesteps riskier assets such as the consumer discretionaries buoying American markets.

One of the greatest risks to a stock portfolio is overexposure, however, so investors should spread assets out evenly.

By packing dividend stocks in a TFSA – and remember, there’s a $6,000 contribution limit in 2020 – income investors can offset that CERB clawback.

At the same time, buying defensive dividend stocks can help to safety-proof a portfolio against a potentially overheated market pumped up by incautious traders.

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Date

2025/08/25
Date Created
2020/06/19
Author
vhetherington