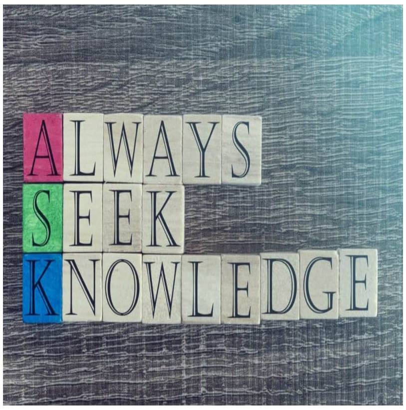

Key Lessons From Previous Bubbles and How To Build Wealth Now

Description

The economic uncertainty we've seen with the coronavirus pandemic truly is unprecedented. Investors today are constantly being reminded of great recessions and depressions in the past. If we indeed are in one of the biggest bubbles in history, how can you defend your portfolio?

I've got a few tips for investors looking for ways to protect their wealth and grow it during this time of uncertainty.

Ignore the temptation to follow the markets momentum

There are times throughout history where we all look back and wonder: why didn't we go against the conventional wisdom of the market? Now is such a time, in my opinion.

Momentum investing, that is, following other investors into stocks that continue to climb higher – has proven, over the long-term, to underperform value investing. I am a traditional value investor and focus on fundamental analysis and stick to the traditional laws of finance. Many of these laws being broken right now. I think taking a contrarian view to that of the broader market could turn out to be very profitable long-term.

But this dip was bullish for momentum investors!

Yes, the dip we saw in the market in March has been just that – a dip. Those who bought the bottom at the end of March have seen their portfolios climb to record highs. That said, the majority of the outperformance in the market has been driven by a handful of stocks. In Canada, this is no different.

Looking at sectors such as energy, one will notice that most companies have not yet rebounded to March 22 levels. This is a sector which has other macroeconomic factors. These include low commodity prices and pipeline constraints that hamper growth

That said, you could now decide whether to invest in sectors which have been beaten up i.e. value sectors like energy. Alternatively, you can aggressively chase sectors like technology. Such sectors continue to make fresh highs on a seemingly daily basis.

Case in point

One company that I think exemplifies this momentum investing strategy the best is **Shopify Inc.** (TSX:SHOP)(NYSE:SHOP). Shopify is now being dubbed the "Canadian Amazon" and has seen its valuation explode accordingly.

The company's price to sales, a very commonly used metric to determine how expensive a company is, is now above 50. This implies an absolutely ridiculous growth rate. At a market capitalization of nearly $165 billion, investors will need to have the present value of all the future cash flows of Shopify come in higher than $165 billion, to make money.

An investor must either have a very low hurdle/discount rate or an extremely high cash flow growth number in their model to make such assumptions.

When valuations become divorced from fundamentals, as they have with Shopify, investors with a momentum focus make a lot of money. Value investors like myself who remain on the sidelines miss out on the party.

That said, history eventually always corrects itself toward a long-term mean. Value investors know this. I'm not saying shorting any tech giant right now is a good idea. Rather, an investor should focus his or her long portfolio on sectors that show excellent price to cash flow fundamentals. This is a much sounder long-term investing strategy.

Bottom line

Over the long term, investors are far more likely to make greater average returns by investing on the basis of value and fundamentals than momentum or growth. Iconic investors like Warren Buffett (who recently purchased a natural gas pipeline for US$4 billion, hint hint) have shown.

I would encourage all Foolish investors to attempt to replicate the likes of Warren Buffett over Cathie Wood, at this point in time. Only time will tell, but 2020 could be a turning point in this regard.

If market volatility picks up again, and another down leg takes stocks lower, the bottom could be much, much lower than what we saw in March.

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