5 Tips to Defend Against Stock Market Pullbacks

Description

It feels great when your stocks are heading higher. However, you've also got to prepare for market crashes or pullbacks.

We could experience a bumpier ride in the months ahead, as the market is trading at near all-time highs partly from support from government programs and quantitative easing.

Here are five tips that can help you hold on to your stocks through market volatility.

Buy quality stocks

A quality company may have the following characteristics. First, it could have a strong balance sheet with manageable debt. Depending on the industry the stock is in, its debt level would be different. Second, it could have resilient earnings or cash flow that tend to grow in the long run.

For example, it's normal for utilities like **Fortis** (TSX:FTS)(NYSE:FTS) and energy infrastructure companies like **Enbridge** (TSX:ENB)(NYSE:ENB) to have a debt to capital ratio of about 50% like industrial and tech stocks that tend to have lower debt levels.

However, the likes of Fortis have earnings or cash flow that are stable enough to sustain a safe dividend. Moreover, their focus on maintaining a reasonable payout ratio also helps keep their dividends secure.

Buy at good valuations

Choosing quality companies is the first step to protecting your capital against market pullbacks. Buying stocks at good valuations is another important safety net. That is, aim to buy these stocks when they're priced at reasonable or better yet, cheap valuations.

Currently, both Fortis stock and Enbridge stock are at least reasonably priced with an anticipated 12-

month upside potential of about 17% and 15%, respectively.

Even when the broader market declines, dragging these stocks even lower, you can be reassured that you bought them at good valuations. You should therefore have greater confidence that they will recover.

Get attractive dividend income

The safe dividend income they provide to shareholders should help investors hold on during excessively volatile times. Particularly, Fortis and Enbridge provide attractive yields of approximately 4% and 7.5%, respectively. These yields provide substantially more income than the Canadian market's yield of about 3%.

By focusing on the periodic returns of the passive income received, investors can more easily shrug off the uneasiness stock price volatility may bring.

Long-term growth

You might hold laddered GICs if you need your cash back in a short time. Stock investing is not meant for short term.

Although stocks could be speculatively traded quickly when given the opportunities to do so, they could generate substantial wealth over the long run as businesses become more valuable.

Talk to long-term investors of Fortis and Enbridge. Given enough time, they were able to double their investors' money with a mix of price appreciation and dividend payments.

Don't forget to populate your portfolio with higher growth stocks like **Intact Financial** and **Open Text**, which have more than tripled and quadrupled their long-term shareholders' money over the last 10 years.

They have also paid bigger dividends over time with five-year dividend growth rates of 9.4% and 13.4%, respectively.

Their relatively low dividend yields of about 2.3% and 1.8% and dividend growth track record suggest they could outperform Fortis and Enbridge with higher growth in the long run. The stocks of Intact and Open Text are attractively priced with a 12-month upside potential of 22% and 27%, respectively.

Have some cash

It would help you (and your wallet) tremendously in market corrections to have cash ready to be deployed. You can set up to have cash coming in periodically — whether that's from your monthly savings or dividend income. This way, you can take advantage of market opportunities that come your way.

The best gains are made from buying wonderful businesses during market corrections!

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