Should You Go Defensive as TSX Stocks Linger Around All-Time Highs?

Description

The **TSX Composite Index** has added 10% to its year-long rally so far in 2021. Despite the uneven impact of the mutating coronavirus, global equities continued to surge and are trading close to all-time highs. But should you, as an investor, worry about these record levels amid the uncertain economic recovery?

Markets at ATH

The semiannual Financial Stability report issued by the U.S. Federal Reserve on May 6 highlights the risks of rising equity valuations. It states that the valuations of some assets are elevated relative to historical norms. In such a scenario, asset prices are probably vulnerable to significant declines if the risk appetite falls.

We have seen a tremendous rally since last March. High-beta stocks, which mainly include re-opening plays, have surged a notable 110% in the last 12 months relative to TSX stocks' 30% gain on average. Vaccine-related news, a stronger economic recovery, and a decently sized fiscal stimulus fueled this rally.

The Fed states that asset prices, mainly from the hospitality, energy, and travel areas, remain vulnerable if progress on containing the virus disappoints.

The warning from the Fed is indeed coming in at a crucial time. Almost all major global equity markets are trading close to record levels. Even if the current rally is backed by ongoing economic recovery and robust corporate earnings growth, valuations will play a key role going forward.

Warren Buffett has been defensive for a long time

Valuations have long been a concern for many investors. One of the most well-known investors is Warren Buffett. Buffett-led **Berkshire Hathaway** is sitting on a mammoth cash balance of approximately US$145 billion. The cash balance kept swelling, as the Oracle of Omaha ran short of worthy opportunities in these overvalued markets. Note that Berkshire Hathaway's cash balance at the end of 2020 is almost 53% of its entire stock portfolio.

Another billionaire investor Michael Lee-Chin is sitting on 50% cash of the portfolio's holding. He thinks that equity valuations are sky high, which will take a tumble, resulting in significant buying opportunities.

I think some parts of equities certainly look overvalued. Impulsive investors have driven the recent rally to a large extent, making it look unreliable in the long term. However, reasonably valued stocks could continue to push the markets higher. Notably, the risks highlighted by the Fed, like the failure to control the pandemic could weigh on overvalued stocks in the short to medium term.

Algonquin Power: One of the best dividend stocks in Canada

Conservative investors can consider increasing their exposure to defensive stocks. Defensives like utilities or telecoms offer stable dividends and provide stability amid market uncertainties. Top utility stock **Algonquin Power & Utilities** (TSX:AQN)(NYSE:AQN) would be an attractive pick in these markets. It earns stable revenues from large, regulated operations and has significant exposure to renewable assets. AQN yields 4% at the moment, which is higher than TSX stocks at large.

Utilities like Algonquin maintain their earnings growth in almost all economic scenarios, which makes their dividends stable. Also, their slow-moving stocks generally outperform when broader markets turn volatile. AQN stock has returned almost 500% in the last decade, notably beating bigger peer utility stocks.

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vinitkularni20