TSX Today: The Real Risk of Stock Investing

Description

The Canadian stock market at its all-time high and a sudden switch to high inflation don't necessarily mean a real risk of stock investing. Investors can choose individual stocks with winning characteristics to ensure success across their diversified portfolios.

The real risk of stock investing is the permanent loss of capital, in which investors lose money on their investments. Here are several factors that could cause you to lose money. Knowing them can help you avoid a permanent loss of capital.

Fear takes charge in bear markets

Any investor can do well in a bull market. However, it takes a heart of steel for investors to not let their fears take charge in bear markets or market corrections.

During the pandemic market crash last year, even blue-chip dividend stocks like **Royal Bank of Canada** (TSX:RY)(NYSE:RY) declined more than 30% from peak to trough. However, its moderate adjusted earnings decline in fiscal 2020 proved only to be temporary. In fact, due to high inflation and a strong economic rebound, the leading bank expects a surge in earnings growth this year.

The boost in anticipated earnings is what has been driving the dividend stock higher. RBC stock has already appreciated 23% above its pre-pandemic high. Those who bought during the 2020 stock market crash locked in a juicy high yield that was sustainable. Indeed, those investors are now sitting on awesome price gains.

Investors must not let their emotions get the best of them during bear markets. Instead, plan for market corrections by buying quality businesses to take advantage of bargain sales and target extraordinary long-term returns.

Insufficient research

Sometimes, investors don’t do sufficient fundamental analysis on companies before investing in them. They might have gotten stock ideas from online, TV, or newspaper and invested in them without doing much research. That can lead to panic selling during a stock market crash when pretty much every stock is in deep red and they don’t know if the businesses they’re holding could withstand the stress that triggered the market crash.

Speculating

Speculating on stocks could be worse than not performing sufficient research on the stocks you’re buying. The latest run-up in meme stock **AMC Entertainment** is largely driven by speculation. The business’s balance sheet is weak. The bubble will eventually burst (or at least leak air) and the stock price would come tumbling down, leading to a permanent loss of capital for its investors. When you speculate on this type of stock, you’re depending on the next guy paying a higher price for your expensive shares.

Business deterioration

Even when you perform due diligence and you believe a company is set up for success, it can still not work out. Macro factors can cause business deterioration. For example, the pandemic triggered a market crash that was more legitimate for certain businesses than others. Some businesses experienced temporary deterioration as they strived to change, while others failed to transform and disappeared.

The Foolish investor takeaway

There’s a way to avoid the real risk of stock investing — the permanent loss of capital. Dividend stocks with a track record of paying increasing dividends tend to be businesses that generate stable earnings or cash flow growth. Aim to buy substantial shares in these dividend stocks during market corrections and you’d be set for life!

CATEGORY

1. Dividend Stocks
2. Investing

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2. TSX:RY (Royal Bank of Canada)

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