Expensive Stock Market: 3 Do's and 1 Don't

Description

The Canadian stock market has climbed about 80% from the pandemic market crash low. It is also about 18% higher from its 2020 pre-pandemic peak. Either way, those are higher returns than the average stock market returns of about 10%. This means that near-term stock market returns could be lower than normal.

No one would argue that the stock market isn't expensive.

It's time for caution.

Here are a few things investors should and should not do.

Don't bet on speculative investments

Don't put your hard-earned money in speculative investments. Say no to companies with poor balance sheets or that are trading at sky-high valuations. Avoid businesses that have great unpredictability for revenue or earnings.

For example, **Cineplex** stock is one to avoid. Its debt-to-asset ratio is dangerously high at 103%. Even if it does work its way out of the excessive debt, it would still be a high risk to take for investors today. There are simply stocks out there with lower risks and higher predictability.

Do have more cash on hand

Place excess cash in short-term GICs, like a three-month GIC. This provides you with the liquidity to buy if a market correction occurs. If you want 100% flexibility in liquidity, store excess cash in savings accounts. The trade-off for the liquidity is that you'll be earning low interest on this cash in the meantime.

Let's say in a normal market, you might have 5% of your investment portfolio in cash. In today's expensive market, you might at least 15-30%.

Do invest in defensive dividend stocks

You don’t necessarily want to exit from the stock market just because it appears to be expensive. The stock market can stay irrational for a long time. The only way to make satisfying long-term returns is to stay invested. Currently, it makes sense to have some money invested in defensive dividend stocks that pay nice income.

Fortis (TSX:FTS)(NYSE:FTS) is widely known as a defensive dividend stock with low risk and high predictability. It also pays a decent dividend.

The regulated utility provides essential electric and gas transmission and distribution. Therefore, the business remains defensive in any economic condition. Even when FTS stock fell during stock market crashes, it would be one of the first stocks to rebound. When money flows back into a depressed stock market, it’s always a flight to quality first.

Fortis stock’s quality is suggested by its 10-year normal premium valuation of about 19.4. Currently, the stock yields 3.6% and is a good place to park some money on a dip. A sustainable payout ratio and growing earnings allow it to carry on growing its dividend in the foreseeable future.

Do update your stock buy list

Keep your stock buy list updated, so you can quickly assess if stock pullbacks are buying opportunities. Separate the list into core holdings and supporting holdings, so there’s no question on what to buy first if things go on sale.

Core holdings should be made up of quality businesses that you are confident in partnering with for a long time without worrying when they sell off during market corrections. Fortis and **Shopify** could be core holding candidates. Supporting holdings like **Cargojet** and **Savaria** may be riskier versus core holdings but could provide better value or growth potential at the time of purchase.

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