



Evergrande Earthquake: How to Navigate Your Stock Portfolio Smartly

Description

The Evergrande earthquake is shaking up the North American markets. The Canadian stock market fell as much as 2.4% yesterday but recovered a bit to be down 1.5% by the time the market closed. Similarly, the U.S. stock market declined as much as 2.8% on the day but recovered to be down 1.7% by market close time.

In the U.S. stock market, the energy sector declined the most at 4.2%, followed by financials (2.7%), consumer discretionary (2.4%), and materials (2.3%). The utility sector fell the least at 0.9%, followed by real estate (1.2%). This could be a preview of the volatility to come.

No matter what troubles come our way, you can navigate your stock portfolio by thinking about diversification, quality, and valuation.

What exactly is the Evergrande problem?

China Evergrande Group ([SEHK:3333](#)) is a large real estate developer in China. It took on a lot of debt to boost growth. That wasn't a problem when everything was rosy. However, all good things come to an end.

CBC [reported](#) that Evergrande “appears to be crumbling under a \$300 billion U.S. debt load. The company missed an \$80 million interest payment on its debts on Monday and is poised to miss another bond payment on Thursday, which has prompted fears the company may default.”

On top of the debt it borrows, based on the assets (primarily real estate properties) it has, Evergrande would also collect deposit money from property buyers to fund the construction of presale properties. So, it becomes a problem when the prices of real estate properties roll over and start falling. The amount it can borrow and the demand for presale properties are expected to decline.

High housing prices in China have continued for years, and the bubble could finally be bursting, as the Chinese government decides to crack down on the real estate sector by tightening credit conditions.

Evergrande stock topped in October 2017 and has actually been in a downward trend since then, accumulating to a decline of about 90%.

What's scary is that unlike North American investors, urban people in China have about 70% of their wealth in real estate. If the Chinese housing bubble really bursts, it could trigger a financial crisis — similar to the one that occurred in 2007/2008.

Diversify across quality stocks

Whenever a storm strikes, some sectors will fare better or recover sooner than others. Having a diversified portfolio with risks spread across quality stocks will help you ride through the turbulence.

What are quality stocks? They are the ones with quality revenues, earnings, or cash flows that are not likely to fall significantly during economic turmoil. Since utility stocks provide essential products and services, the sector has fallen the least in recent trading. If you hold shares of quality utility stocks like **Brookfield Infrastructure** and **Fortis**, you should all the more feel at ease.

Valuation

Even for the highest-quality stocks, you don't want to overpay. In terms of Canadian Dividend Aristocrat [Fortis](#), it means waiting for a yield of close to 4% before considering buying. Each stock is considered a bargain at different discount levels. The higher the uncertainty of a business's profitability, the bigger margin of safety you should require before buying its stock.

The Foolish investor takeaway

Either the Evergrande fallout or some other black swan event could trigger a market correction. Always navigate your stock portfolio by maintaining a diversified portfolio of quality stocks and aiming to buy when they're attractively valued. By doing this, you will greatly reduce your risk and boost your long-term returns.

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1. Dividend Stocks
2. Investing

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