Stock Investing for Dummies: 3 Do’s and 1 Don’t

Description

If you’re just starting investing, you want to keep it as simple as possible. Write down a set of rules you can easily follow. Here are three do’s and one don’t for stock investing for dummies.

Stock investing for dummies: Buy stocks that are growing in profits

Thanks to online brokerages and the internet, it’s super easy to start stock investing. When you buy shares of a common stock, you become a part-owner of the underlying business. You share the risks and rewards. Therefore, you want to buy stocks that are growing in profits, so you can share its profits.

Stocks must first have revenue before they can have earnings. For example, **Royal Bank of Canada** (TSX:RY)(NYSE:RY) stock’s trailing-12-month (TTM) revenue is just under $45 billion, while its net earnings available to shareholders were approximately $15.1 billion.

The big Canadian banks are an oligopoly. As the leader, Royal Bank has stably increased its profits over the decades. Over the last 20 years, Royal Bank has increased its earnings per share at a compound annual growth rate of 9.6%. The dividend stock delivered total returns of 10.7% per year in that period. An initial investment of $10,000 would have transformed into approximately $76,719.

Invest in dividend stocks

When stocks profit, they can retain earnings to reinvest in the business or pay out the profits as dividends. Dividend stocks do both. Specifically, in the TTM, Royal Bank paid out $6.4 billion of dividends, which equated to a payout ratio of roughly 42%. In this period, the Canadian bank stock also repurchased shares of a similar amount, which helped drive the rebound in the common stock after the ridiculous selloff during the pandemic.

Currently, Royal Bank yields about 3.3%. However, its low payout ratio compared to the range of 45-

55% in the past 10 years should result in a nice dividend hike soon after the regulator lifted the dividend freeze ban on the federally regulated financial institution. A dividend increase of 7-16% is possible.

Buy stocks when they're cheap

Ideally, you'll want to buy stocks when they're undervalued so you pay less for more. However, that requires market timing. To keep it simple, people must just buy shares of quality businesses that are growing in profits over time as their paycheques arrive in their accounts and excess cash becomes available.

Currently, Royal Bank stock is fairly valued and can still deliver long-term returns of about 9% per year. If you're looking for a sale, you might have to wait for black swan events like the pandemic last year that dragged down the stock by more than 30% from peak to trough.

Don't put all your eggs in one basket

No matter how attractive a stock appears to be, don't invest all your money in it. In other words, don't put all your eggs in one basket. If you do, and the stock fails you, you'll lose your nest egg. Instead, diversify your hard-earned money across a diversified basket of quality stocks that are growing in profits and perhaps pay a nice dividend income. Over a market cycle, you'll find that stocks from different industries will perform at different times.

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