Stock Market Investors' Key Lessons From 2021

Description

2021 has indeed been a banner year for equity markets, marking an unstoppable recovery from the pandemic lows and laying a solid ground for 2022. Canadian markets added 20%, while the **S&P 500** surged a notably 30% in 2021. The top-performing energy sector also bounced back with an 80% gain this year, creating massive wealth after digging a deep hole in investors' pockets in the last four to five years.

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Apart from the solid gains, the stock market awarded some great lessons for investors this year. Here are some of them.

Cope with behavioural biases

The year 2021 began with the fears of market crash amid dominating coronavirus variants. Naysayers were busy mongering fear almost throughout the year. An obvious reaction would be to panic and get out of the markets. However, those who effectively ignored the market crash rhetoric and remained invested won.

Equity markets function in cycles. The pandemic crash in March 2020 taught us the same thing. COVID-19 pulled stocks down by approximately 35% in just a few weeks. But was it the end of the world? No!

Discerned investors even managed to buy quality names on dips and increased their holdings. So, it's even more important to deal with our behavioural biases while investing. Don't let fear and greed dominate your investing decisions.

Keep inflation in mind

Rising inflation means cash will lose value even faster in the future. It makes great sense to invest your surplus cash in quality stocks for the long term. Indeed, some stocks will underperform with inflation trending higher but, sectors like energy perform better in an inflationary environment. So, instead of earning minimal returns with low-risk investment options, it is prudent to invest in stocks.

Diversification goes a long way

Diversification across asset classes, within sectors and with aggressive-defensive stocks should go a long way. Defensive stocks like **Fortis** or **BCE** outperformed during the crash last year. But as markets readied to take higher risks, defensives lost their sheen, and risky growth stocks significantly outperformed. So, diversify based on your risk appetite.

Even if one stock or sector underperforms, the other one in your portfolio should compensate for the underperformance. That is why, even if you are an aggressive investor, it makes sense to have some exposure to defensives.

Go for index funds

But not every investor has the acumen to pick stocks that could outperform in the long term. Warren Buffett suggests index funds for such investors. He is a long proponent of index funds, and **Berkshire Hathaway** has invested in some of those.

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An index fund is a basket of stocks that give investors broad market representation. They are low risk and offer diversification.

If you are looking to bet on Canadian markets at large, consider **iShares S&P/TSX 60 Index ETF** (TSX:XIU). The fund's top components include **Royal Bank of Canada**, **Shopify**, and **Toronto-Dominion Bank**, which collectively form 21% of the fund. XIU has returned 25% so far this year.

Investing in stocks via index funds is a smart move. Investors can generate decent returns without the hassle and without losing peace of mind. So, if you want to become a better investor in 2022, consider index funds.

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