3 of Investors’ Worst Fears (and How to Avoid Them)

**Description**

What do investors fear most, and how can they reduce the chance of these fears happening? Let’s discuss some of these possibilities and how to avoid them.



## Investment portfolio experiences substantial downside

Some investors may not know how risky their investment portfolios are until a bear market happens. Stock portfolios can have substantial downside risk depending on the holdings you own. For example, some growth stocks, such as **Docebo**, were cut in half (if not worse) this year versus a year ago.

If your whole portfolio were populated with these kinds of stocks, it would have been devastating for your wealth creation. At least, it would dampen your near-term wealth creation. At worst, you could sell and materialize huge losses.

Unfortunately, even if you can withstand the volatility, some stocks that experience substantial losses will never fully recover.

You could reduce the probability of experiencing considerable downside by having portfolio diversification and utilizing proper asset allocation. For example, **iShares Canadian Growth Index ETF** has 39 growth stock holdings with the top 10, making up about 62% of the fund.

Even just the top 10 holdings provide a nice example of diversification across two railroad stocks, an asset manager, two tech stocks, one telecom stock, one energy infrastructure stock, an agriculture input stock, a waste management company, and a convenience store consolidator.

## Total loss in investment

A total loss in an investment is when a business goes bankrupt. If a business disappears, it may not pay back the amount it owes in bonds and interest payments (or partial payments may occur). If it cannot pay back all its loans, its common shares would also become worthless.

Careful selection of investments after due diligence can mitigate this risk. You might incorporate some rules in your investment selections, including businesses with durable earnings or cash flow and an investment-grade balance sheet. Portfolio diversification can also help protect your wealth so that even when one of your holdings disappeared, the rest would still be intact.

## Income reduction

Buying investment-grade bonds with shorter-term maturities will lower your risk of reduction in interest income. Buying a portfolio of quality dividend stocks can protect your stock portfolio income. Even if one dividend stock were to cut its dividend, your other dividend holdings could increase their dividends to fill the gap.

For example, between **Fortis** (TSX:FTS) and **Algonquin Power & Utilities** (TSX:AQN), the latter has a higher chance of cutting its dividend due to having higher debt levels on its balance sheet and having a higher payout ratio.



Fortis also has a longer dividend-growth streak of close to half a century, whereas Algonquin's dividend-growth streak is about a decade. Algonquin has an investment-grade S&P credit rating of BBB, but Fortis's is more solid with an A- rating.

Fortis's payout ratio is estimated to be about 79% of this year's adjusted earnings, whereas Algonquin's 2022 payout is estimated to be about 107%, as management reduced its 2022 earnings-per-share forecast in the recently released third-quarter results. AQN stock currently yields 9.4%. The market is now anticipating that a potential dividend cut in the utility could occur next year.

## The Foolish investor takeaway

Investors can mitigate investment or portfolio risk in multiple ways. First, aim to build a properly diversified portfolio that can consist of stocks and bonds. Second, consider only investing in quality securities that are investment grade. Also, when choosing dividend stocks, if you care about dividend safety, having sustainable payout ratios is only the starting point.

**CATEGORY**

1. Investing
2. Stocks for Beginners

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1. TSX:AQN (Algonquin Power & Utilities Corp.)
2. TSX:FTS (Fortis Inc.)

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