Analysts forecasting market volatility will continue

The Canadian and U.S. markets have been riding the swells and troughs of very rough seas, characterized by 100-plus point swings in recent months.

Many analysts have forecast that this market volatility will continue for some time to come.

So, what does this mean to you? Go for dividends and stay invested. It is tempting to move into cash or T-Bills and try to jump back in on the next pull back.

But who can time the market? In the period from 1982 to 1990 missing out on the markets best 30 days would have reduced average annual returns from 18 per cent to five per cent.

Your investments would have gone from exceptional to inexcusable. One of the worst ways this market can play itself out is a period of investor nervousness. This will cause stormy ups and downs but result in little change in value over the long haul, known as a sideways market.

In a case like this, consistently making money from equities will be a challenge.

One way to weather the volatility and protect your wealth is to be in dividend yielding stocks or funds.

By taking advantage of dividend reinvestment programs your dividends will be used to purchase additional shares more frequently. This dollar cost averaging smooths out the highs and lows in purchase price and allows the magic of compounding to do its work.

Assuming a trading market characterized by a prolonged sideways movement, a healthy dividend portfolio will ensure compounding returns.

For example, assuming a four per cent dividend growth rate with reinvestment of the dividend into the same shares, the investor will earn $612 on a $1,000 investment over 10 years if the stock does not move in price.

If the share price falls to one-half its original value over five years and rebounds to the starting price by year 10, the investor will earn $932.

This compares to just $488 on a compound return at four per cent (if you can get it) at the bank. An additional bonus is that dividends receive more favourable tax treatment than interest, which adds to the equities' returns.

Remember, the greatest long term risk of stocks is not owning them.

This article was submitted by Richard Box, an Investment Advisor with TD Evergreen Investment Services.