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Investors on the sidelines

A strategy for moving forward

The markets have rallied with such vigor that many investors have been left on the sidelines. Still reeling from the crash, some were skeptical of the rebound and felt it was unjustified while others were simply nervous and worried about losing even more money.

Regardless of their reasons, at this juncture those investors face difficult choices. Do they invest now, in anticipation of a continuing rally, or do they wait and hope for another dip? It's the million-dollar question for which there is no consensus, although assorted opinions abound.

In July, the Bank of Canada declared that the recession was over and has since corroborated with "the second half of 2009 could be stronger than projected". South of the border, US Federal Reserve Chairman Ben Bernanke recently cautioned, "even though from a technical perspective the recession is very likely over at this point, it's still going to feel like a very weak economy for some time". Warren Buffett said the economy "hasn't gotten worse" but added that it hasn't improved much either. He said that, unless there is some unforeseen "horrible event", he believes "we've quit going down".

The worst would appear to be over. However, even though there may be more optimists than pessimists, investors should not throw caution to the wind. There is still much uncertainty in the markets, which breeds risk, and investors should not rush back in without regard for planning. To mitigate potential volatility, they need a plan that includes both strategic and tactical elements.

Those who missed out on this year's rally have lost significant upside. To offset that, they should place more emphasis on total return. When a significant piece of stock price appreciation has been missed, dividends and interest will play a much larger role in determining portfolio growth moving forward.

Applying an income strategy usually provides more stable return patterns because dividend yields tend to be more predictable than simple price appreciation. They can also provide some downside protection; the idea being that you are paid dividends while waiting for price appreciation. If we experience further volatility, dividends should help cushion bumpy equity markets.

Investors should look for good quality companies that have lagged the rally. Many companies have been out-of-favour over the last few months despite being excellent businesses. While some are more defensive in nature, they tend to offer the added benefit of solid dividends.

Shoppers Drug Mart (TSX: SC) is a good example. It's trading at attractive levels and is currently near its annual low. The stock offers a nice dividend and has consistently raised its dividend since it was established in 2005. Many of the products it sells are needed in day-to-day life so the stock is more of a defensive play, but keeping a percentage of your portfolio defensively positioned during uncertain times is wise.

It's difficult to say with absolute certainty where the markets are going from here, but investors who take a strategic approach to their investing shouldn't fret too

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much about having missed a rally. As always, think carefully, choose wisely and act appropriately.

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