GRIN AND BEAR IT

By Jacob Ansel

> ***Stock corrections are inevitable, but there are ways to minimize the impact. Investment success generally hinges on long-term thinking; however, most investors worry about day-to-day shifts in their portfolios. Some of that worry is justifiable given the market's recent volatility.***

WHAT GOES UP MUST OCCASIONALLY go down. While investors shouldn't completely change their long-term plans at the drop of a hat, making simple adjustments to a portfolio can help cushion losses or exaggerate gains. Even the smallest retail investor can benefit from tweaking a portfolio during a bear market. There are scores of pundits making the case that we're already in a bear market. Financial markets generally move in seven-year cycles, and we're at the end of the bull that began in 2009.

A bear market is a market that shows a lack of conviction. It's traditionally defined as a period of negative returns in the broader market of 15 to 20%, or more. Stock prices drift sideways or fall, indices drop, and trading volumes are stagnant. Brokerage cash and bond balances are generally higher, newspaper headlines turn pessimistic, and investors feel less confident. While a few up or down days don't make a bull or bear market, two weeks or so of stock surges or declines could signal the kind of market we've entered.

There are several strategies used when investors believe that a bear market is about to occur or is occurring, which depend on an investor's risk tolerance, investment time horizon, and objectives. One of the safest strategies – as well as the most extreme – is to sell all of your investments and either hold cash or invest the proceeds into much more stable financial instruments, such as short-term government bonds. By doing this, an investor reduces exposure to the stock market and minimizes the effects of a bear market.

For investors looking to maintain a position in the stock market, a defensive strategy should be taken. This strategy involves investing in larger companies with strong balance sheets and a long operational history, which are considered to be defensive stocks. Focusing on blue chip stocks could prove fruitful in bear markets. Blue chips are better equipped to handle any possible downturns in the market, and their bulk offers advantages in a slowing and uncertain economy.

These advantages include larger dividends, the ability to acquire floundering smaller competitors, and lower volatility. They tend to be less affected by an overall downturn in the economy or stock market, making their share prices less susceptible to a larger fall. With strong financial positions, including a large cash position to meet ongoing operational expenses, these companies are more likely to survive downturns. Riskier companies, such as small growth companies, are typically avoided because they're less likely to have the financial security required to survive downturns.

Given that a bear market is all about a lack of confidence in the economy, investors could turn toward safe havens during this time. That means adjusting the percentage of bonds you hold upward. Essentially, a bond is an IOU that companies and governments issue to fund their day-to-day operations or to finance specific projects. Bonds are less likely to lose money than stocks and can reduce your portfolio's losses during market declines. Bonds also pay interest regularly, so they can help generate a steady, predictable stream of income from your savings in bad times.

There are other alternatives investors can bet on to tackle the bear. Shorting stocks through an inverse ETF (an exchange-traded fund is traded on a public stock market which is designed to perform as the inverse of whatever index or benchmark it's designed to track) or adding bear market mutual funds could provide short-term relief from dwindling stock prices. At the same time, betting on market volatility or its fear might make sense. Make sure to take advantage of tax losses in a bear market. Sell securities that are losers and which can offset any capital gains and capital gain distributions, or capital gains from the sale of a home, business, or building.

While investors shouldn't feel compelled to change their portfolios radically in reaction to the market's daily moves, small adjustments in the face of a bear market could be a smart move. Adjustments to how the market perceives risk could save investors from catastrophic losses. ❑

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