RECESSION-PROOF YOUR PORTFOLIO

When the economy shows signs of slowing down, it is inevitable that share prices will take a hit. A recession is never good news, but there should be no need for investors to panic. Instead, it offers an opportunity to review your portfolio and ensure that it is positioned to weather any storms which might lie ahead. This does not mean you need to make sweeping changes. After all, weatherproofing your house against the winter does not mean you tear it down and rebuild it. Instead, you make sensible, incremental changes that provide some additional strength.

So here are our top ten practical tips to help you fight off the worst effects of recession...

1 Tip No 1: Diversify.

It is the basic number 1 rule of investing but it needs reaffirming. Different asset classes perform well or poorly at different times. If your portfolio is exposed to a single asset class – for example, equities – its performance will follow the fortunes of the equity market, and returns are likely to be volatile. However, if your portfolio contains a selection of different asset classes, and is also spread across different countries and regions of the world, the different elements will perform differently at different times – so if one is doing badly, the chances are another will be doing better and should compensate for some of the downside.

2 Tip No 2: Look beyond your home market.

With diversity in mind, perhaps you can start looking overseas for opportunities. A UK-focused portfolio might seem a sensible and conservative option for a UK-based investor. However, this strategy leaves you and your portfolio at the mercy of only domestic sentiment. Other areas of the world may offer a more positive outlook during this time or could simply be better placed to help you through any domestic downturn. You need to be aware of the different risks involved with different international markets but even a small step into developed western economies can diversify some of your risk.

3 Tip No 3: Be prepared to roll with the punches.

Your attitude during negative periods is as important as your portfolio's structure. Economies can't keep growing indefinitely, and recessions are likely to happen every few years. Successful investors tend to be pragmatic and realistic, they invest for the long term and expect that whilst there will be good times, there will also be some bad. A short-term downturn should not be seen as reason to panic.

4 Tip No 4: Look beyond the economic data.

Remember that economic data releases are backward looking. At the start of a slowdown, figures will continue to appear positive, perhaps contradicting our everyday experiences, as old data remains in the calculation. Similarly, once economic growth begins to recover, it will take a while to be fully reflected in the new data. Headlines that scream "worst figures for 30 years" confirm what we have just been through but do not necessarily reflect the prospects for tomorrow. What they do, however, is fan the flames of investor uncertainty - and sell newspapers!

Tip No 5: Cash is not necessarily king.

During a recession, it is very tempting to get out of the stock market and opt instead for the perceived safety of cash. However, this strategy can be risky. Stock markets are volatile, which means that, just as they can fall quickly, they can also recover quickly, with little or no warning. If equities are the right asset class for you, moving out of them when you have already suffered a loss could mean missing out when they finally begin to recover. Moreover, inflation can impact the purchasing power of cash over time. You can be assured that you will not lose the capital value of money when invested in cash but it should not be considered a “risk-free” option!

Tip No 6: Go for quality.

During recessions and stock market downturns, high-quality established companies tend to bear up better than their newer or more debt laden peers. A tough environment helps to separate the wheat from the chaff; struggling companies may be forced to cut their dividends and release negative trading statements. Holding quality stocks, therefore, could help you ride out some of the storm. It is also worth noting that, if everything is falling, this could provide a great opportunity to pick up more quality stocks at relatively cheap prices.

Tip No 7: Assess your exposure to small caps.

Historically, as an asset class, smaller companies have been the worst affected during a recession. You therefore need to be sure of your attitude to risk before you take any significant holdings. When things are going well, small caps can offer the possibility of greater gains than their larger peers – but when things are going badly, the losses can also be much greater. If the volatility makes you nervous or your portfolio is relatively small, consider reducing your exposure to small caps and perhaps reinvest into some higher-quality choices.

Tip No 8: Check if you are overexposed.

Different industry sectors tend to perform well at different stages of the investment cycle. During an economic slowdown, some companies are less sensitive to the effects because we all continue to need them, even though our income falls – food retailers, pharmaceuticals and utilities for example. Consequently, these tend to hold up better than, say, leisure companies and house builders which depend on us having money to spare. It is always worth holding onto high-quality companies regardless of short term hitches - but now may be a good time to ensure you are not overexposed.

Tip No 9: Think long term.

‘Recession’ is commonly defined as two consecutive quarters of negative growth (in the Gross Domestic Product or GDP). Six months in the average lifetime of a portfolio is not long o– and even if you take into account the negative behaviour of markets both in anticipation of and in the aftermath of such data, it is still only a short time compared with the 20 plus years over which we plan for our retirements. If your portfolio meets your personal criteria and is well diversified, a recession should not cause you to change plans. Sometimes doing nothing is best.

Tip No 10: This is a fire drill – not a fire.

Remember the saying ‘If you can keep your head whilst all around you are losing theirs...’? Market downturns are a great example of when this applies. A fire drill is a good thing: the fire might never actually occur; however, if the worst happens, at least you can be confident you have taken all the appropriate precautions!

The real secret is to make sure you plan your portfolio properly, with an expert, at the outset. Then, when a downturn strikes, you can stay calm and review sensibly with confidence, rather then be panicked into radical, unprofitable change.

If you have any questions about your own portfolio or would like to discuss the best mix of investments to meet your needs at this time, please give us a call.

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