3 Ways to Protect Yourself From Falling Equity Prices

Description

There's no denying that stocks have been on a great run over the past five years, but one has to wonder how long that can last. It now seems that every other day, there's a new story about how much stocks are overvalued, and that we're due for a correction.

Does that mean you should sell all your stocks? No it certainly does not – stocks are meant to be held for the long term, and trying to time the market is usually a losing game. Your weight toward stocks should be based on personal factors like your return objectives, risk tolerance, and time horizon.

But there are still ways to protect yourself, even when staying in the stock market. Below are just three examples.

1. Stable stocks

The simplest strategy is to buy companies with stable businesses that ride out economic cycles with ease. One example is **Metro** (TSX: MRU), the third largest grocer in Canada. Food, of course, is a product that doesn't fall off dramatically when times are tough, and likewise doesn't explode in sales during the good times. As a result, the fortunes of Canada's grocers aren't very dependent on the state of the economy. Likewise, their equity prices aren't going to experience as much volatility as most other stocks.

Furthermore, Metro has been very well run over the past two decades, and as a result its quarterly dividend has been raised every year for the past 19 years.

2. Fairfax

If you think stocks are overpriced, you have something in common with **Fairfax Financial Holdings** (TSX: FFH) Chairman & CEO Prem Watsa. Due to Mr. Watsa's pessimism, the insurance conglomerate has a very conservative investment portfolio, with a heavy investment in bonds, and the entire equity portfolio hedged.

It's a strategy that has cost Mr. Watsa and Fairfax's other shareholders in recent years as the market has rallied. But one only has to go back to 2008 to see what happens when Fairfax's pessimism pays off. In that year, Mr. Watsa bet heavily against subprime mortgages, and Fairfax stock increased more than 30% in a year when seemingly every other stock fell off a cliff.

It's unlikely that something that extreme will happen again any time soon. But if the markets do turn south, Fairfax will surely outperform again.

3. Bear ETFs

This third strategy is the most extreme, but also the most effective. Buying a so-called bear ETF is effectively a bet against equity prices, one that will always be effective if the stock market turns south (unlike the two strategies above). The most popular of these ETFs are the Horizons **BetaPro S&P/TSX 60 Inverse ETF** (TSX: HIX) and **BetaPro S&P 500 Inverse ETF** (TSX: HIU).

This strategy is best if you're holding individual stocks, but want to reduce your overall equity exposure. It's a lot more effective than selling your stocks; it not only allows you to continue betting on names you believe in, but also saves you from hefty trading costs.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:CNDI (BetaPro S&p/tsx 60 Daily Inverse ETF)
2. TSX:FFH (Fairfax Financial Holdings Limited)
3. TSX:MRU (Metro Inc.)

Category

1. Investing

Date
2025/07/17
Date Created
2014/05/12
Author
bensinclair