What Should You Do if You're Worried About a Market Crash?

Description

Markets hitting new highs won't be the cause of a crash. However, we know that history can repeat itself, and that sometime in the future, a market crash will occur.

If you're worried, here are a few things you can do.

Focus on quality and stability

If you're building a stock portfolio, you can hand-pick the most quality of stocks which have stable underlying businesses that continue to churn out higher profitability over time.

The top Canadian banks are the most profitable publicly traded businesses in Canada. Moreover, they have strong S&P credit ratings of at least A+. If you have these banks in your portfolio, you can rest assured that they can withstand market crashes and come out stronger.

For example, the share price of **Royal Bank of Canada** (TSX:RY)(NYSE:RY) and the other big banks fell as much as 50% during the Financial Crisis. However, their profitability didn't nearly fall as much. Now, about eight years later, all of the Big Five banks generate higher earnings per share than they did before the crisis.

quality
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Diversification

That said, if the banks make up too much of your portfolio, your portfolio could fall a lot in the next crash.

To prevent that from happening, you could set a maximum allocation of 20% of your portfolio in each sector. This way, your portfolio won't be wiped out by problems that may arise in any specific sector.

So, you should consider enough diversification for your portfolio such that you don't have too much in a single sector or stock. For instance, some investors don't allow a stock to exceed 5% of their portfolio.

Other stable sectors that tend to generate higher profits over time include telecoms and utilities.

Dividends

In a market crash, it's likely that all stocks will fall. In such a scenario, dividends can help you hold on to the stocks. It turns out that the banks, telecoms, and utilities typically generate decent dividends.

Royal Bank, **BCE Inc.** (TSX:BCE)(NYSE:BCE), and **Fortis Inc.** (TSX:FTS)(NYSE:FTS), the leaders of their packs, all generate yields of at least 3.6% that maintain your purchasing power, even in a market crash.

Save up more cash

If you're still worried, save up more cash. Some investors actually have as much as 20% of their portfolio in cash as the markets reach new highs. That way, these investors can buy stocks when they become bargains.

Investor takeaway

Long-term investors should not worry about market crashes. Instead, they should stay the course, maintain a diversified portfolio, and invest in quality and stable dividend stocks that grow their profitability over the long run.

Additionally, it makes sense to build an above-average cash position as bargains are hard to come by in today's elevated market.

CATEGORY

1. Bank Stocks
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