



## How To Guard Your Portfolio Against Political Risk

### Description

At the present time, investors face significant levels of political risk. For example, in the US there is uncertainty regarding the future spending plans of the administration. This could affect share prices because the recent Bull Run has largely been built on the prospects of a higher economic growth rate. Similarly, in Europe the EU faces a difficult future, with Brexit posing a challenge and the economy's performance continuing to be mixed.

Here's how investors can overcome those problems, and other political risks over the long run.

### Margin of safety

The simplest way to overcome the political risks facing investors is to seek a margin of safety. This essentially means buying a stock for a price which is below its intrinsic value. Clearly, the margin of safety sought by an investor is subjective and will vary, but given the relatively high valuations on many share prices at the present time it may not be possible to obtain a large discount to a stock's intrinsic value.

Still, at least some margin of safety could be useful because it may provide limited downside, as well as above-average upside potential. This could allow an investor to outperform the wider index over a sustained period.

Furthermore, obtaining a wide margin of safety may also provide an investor with a more patient outlook regarding the performance of their portfolio. If an investor knows that he/she has purchased a stock for a good price, they may be less concerned with any short term volatility or fluctuation. This may help them to remain disciplined and more level-headed should global shares fall due to political or other risks.

### High-quality stocks

Another means of potentially overcoming political risks faced by investors is to seek high-quality companies. As with a margin of safety, what determines a high-quality stock is subjective. However,

strong fundamentals are a sensible starting point, with a sound balance sheet which does not contain large amounts of debt likely to be important over the medium term. This is because, with inflation expected to move higher on a global basis, companies with high debt levels may find their profitability squeezed as the cost of servicing debt increases.

Other aspects which could determine the quality of a company include its cash flow and economic moat. These two areas could be important in overcoming political risk because strong cash flow may help to support a company's dividend payments and its ability to invest for future growth. Furthermore, an economic moat may help a company to outperform rivals in a more competitive operating environment. Such stocks could gain favour among investors during a challenging period for major stock markets.

## Takeaway

While political risk is ever-present for investors, right now it is arguably greater than it has been in recent years. Therefore, focusing on a margin of safety and the quality of companies held within a portfolio seem to be prudent steps for investors to take. Doing so could help to not only reduce risk, but also improve total returns over the long run.

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