How Should Investors React to the “Fire and Fury” Turmoil?

Description

Global markets were rattled yesterday following a war of words between President Trump and North Korean leader Kim Jong-un. Trump thought that his “fire and fury” comments a few days ago wasn’t a tough enough threat, as Kim Jong-un continues threatening the U.S. with his stockpile of nuclear weapons.

How should investors respond to this geopolitical turmoil?

As threats are passed back and forth between Donald Trump and Kim Jong-un, the markets will probably continue to pull back. Personally, I don’t think we’re on the brink of war, and investors certainly shouldn’t overreact to the rising tensions between North Korea and the U.S.

If you’re afraid of a potential market meltdown, just take a few steps back and remember to concentrate on your long-term goals. Timing the market based on speculative, fearful news is not a great way to make money; in fact, you may miss out on a possible rally if investors get used to the threats from North Korea or if the U.S. can figure out a way to ease the tension.

Corrections happen often. Usually, when they’re triggered by speculative events, it’s probably a good time to be buying shares of beaten-up stocks. Whether the average investor is afraid of war or not, the markets were still overvalued, and the occasional correction is healthy for a market like the one we’re in, which has gotten quite frothy over the past few months.

Is it even possible to profit from the fear as the CBOE volatility index hits the pre-presidential election levels?

I believe now is the time to be picking up shares of your favourite stocks that have been hit hard this past week because of the geopolitical turmoil. In the most likely case where nothing arises out of the rising tensions, we could witness a relief rally. Over the next few days, headline risk is going to be high, and it’s expected that more threats will be traded between Trump and Jong-un, which will in turn trigger another huge down day like the one we witnessed yesterday.

Still somewhat afraid? How about some beaten-up "defence" stocks?

If you are afraid of more downside, but you still want to seize the opportunity to buy on market-wide sell-offs, then treat further declines as a chance to pick up shares of bomb-shelter names such as **Canadian Utilities Limited** (TSX:CU) or **Fairfax Financial Holdings Ltd.** (TSX:FFH), both of which are cheap stocks that tend to outperform when the markets as a whole start getting ugly. Fairfax actually rallied during the recession, while Canadian Utilities was quick to rebound. Investors who continued to buy on the way down were rewarded rather quickly. These two defensive names are all about minimizing risk and preserving capital.

Buy while others are selling

Does that mean you should flee to defensive stocks immediately? Not necessarily. If you're like me and think there's a ridiculously low probability of anything arising from the tension, then you should buy the stocks that were on your watch list regardless of their industry. But defensive names are still very important to have, and if you don't have any such holdings, then treat this sudden turmoil as a wake-up call.

Everyone was overly bullish, and the U.S. markets have gotten expensive, but that can all change in just one day, so it's important to ensure your portfolio is prepared to deal with such down days. If you've got cash on hand, then it's time to go shopping as the markets continue to nosedive.

Stay smart. Stay hungry. Stay Foolish.

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Author
joefrenette