3 Tips to Protect Your Portfolio From Market Crashes

Description

There's no doubt about it. Market crashes are scary to experience. In the last recession, as safe as big Canadian banks are, they, including the leader **Royal Bank of Canada** (TSX:RY)(NYSE:RY), still lost as much as half of their market values from the peak to the trough!

When it comes to market crashes, investors can be very irrational, and the short-term price actions are very much driven by emotion and rather than by facts and fundamentals.

How can you protect your portfolio from market crashes then? Here are some tips to do just that.

Invest in defensive stocks

You can invest in defensive stocks, including Royal Bank and **Fortis Inc.** (TSX:FTS)(NYSE:FTS), when they're undervalued. Then you can sit back and collect a growing stream of dividend income in good times and bad.

Royal Bank looks reasonably valued, while Fortis hasn't traded at this cheap a multiple since 2009. That said, there's a reason for Fortis's contracted multiple. Its growth is expected to be dampened by higher interest rates.

The sure thing about defensive stocks is that they'll still be here years from now. So, once you buy shares at good prices, you can pretty much sit on them and watch them grow in a stable way in the long run.

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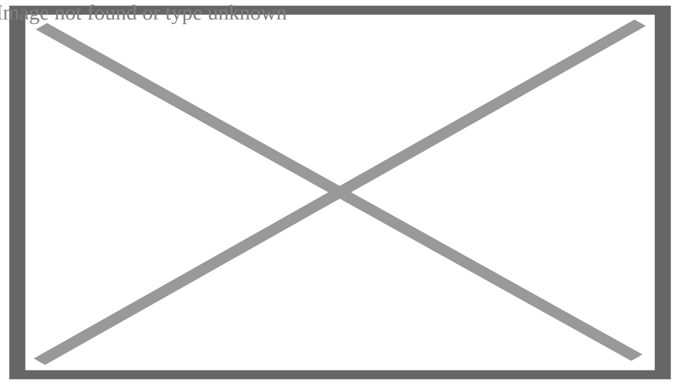

Diversify

Traditional businesses, including the likes of Royal Bank and Fortis, can help stabilize your portfolio and make you sleep better at night, especially in turbulent times.

On top of these traditional businesses, you can add more diversification by sprinkling growth stocks in your portfolio. For example, while interest-rate sensitive stocks have corrected lately, technology stocks, such as **CGI Group Inc.** (TSX:GIB.A)(NYSE:GIB), have done very well with their above-average growth.

Investors don’t necessarily need exposure to every industry and sector to be diversified. However, it makes sense to get exposure to companies in different sectors that continue to increase their profitability. In a market crash, it’ll be easier to hold on to a diversified portfolio versus one that is concentrated.

Put things in perspective

Market crashes, like storms, will pass. If you hold a diversified portfolio of quality stocks, your portfolio will recover from market crashes and eventually make new highs. Investors need to keep that in mind when a market crash inevitably occurs.

Investor takeaway

In all their power, investors can build a defensive and diversified stock portfolio. However, at the end of the day, they need to be able to hold on to their stocks in market crashes. So, prepare your mind by performing mental exercises to visualize how market crashes could affect your portfolio.

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