Getting Nervous About the Markets? Try This Strategy

Description

As you've probably heard by now, the stock market now finds itself in this, the ninth year of the current bull market dating back to the end of the 2008-2009 financial crisis.

As far as history repeating itself, the data suggests that these cycles typically last only about six years or so.

But if that weren't enough to start making investors nervous, interest rates are now starting to tick back up again.

This week the rate on 10-year Treasury notes crossed above the 3% threshold, a symbolic sign that the era we've been enjoying for the past 10 years or so of "lower rates for longer" appears to be finally ending.

The bad news is that when interest rates rise, borrowing costs for consumers, who may want to purchase a new car or home, will be higher.

It also makes borrowing costs higher for corporations, who typically have hundreds of millions – if not billions – of dollars of financial obligations on their balance sheets.

Frankly, that does not bode well for the economy or the stock market.

While 2018 has certainly proven to be a volatile period for the markets, this all suggests that the worst may not be over.

As a result, you may want to start thinking about taking a little risk off the table or buying a little added protection for your portfolio.

Using a "protective put" strategy in your portfolio

You can think of a protective put strategy the same way you would an insurance policy on your car or home.

Protective puts give you the ability to protect your investment should something go wrong.

Say for example, you owned shares in **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD), but were concerned about a major threat to the financial sector or the Canadian economy as a whole.

You could hedge some of your risk in your TD shares by buying a put option that would afford you the ability, in advance, to sell your TD shares at a predetermined price; this is called the *exercise price.*

That way, even if TD stock declined in value, you would still be able to sell your TD shares at the exercise price on your put contract, effectively saving yourself from losing any money on the position, less the premium you paid for the puts.

Meanwhile, if the price of TD stock were to appreciate, you would then be able to participate in those gains, less the cost of the put contract that you purchased.

This works in the same way that home insurance protects you from suffering a major loss, yet also allows you to benefit from the appreciation in your property value (less the cost of the insurance premium).

But remember…

While derivatives and strategies such as a protective put can offer certain benefits when it comes to risk management, they are not without risks.

Buying out-of-the-money options, for example, is a strategy that can see you lose the entire value of your investment in the blink of an eye.

Thus, be willing to trade with a *Foolish* mindset, but also make sure you've done your homework first and consult with a financial advisor to see if an options strategy is right for you.

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