How to Prepare Your RRSP or TFSA for the Coming Bear Market

Description

Over the past 10 years, North America has witnessed an unprecedented, long economic expansion that has defied all expectations. Despite years of commentators bemoaning quantitative easing and the expected inflation that would come with it, we instead witnessed a long growth spurt combined with minimal currency devaluation.

Along with the economic growth came impressive stock market gains. Although the TSX has lagged, U.S. markets surged forth almost every year since 2009, and are now nearing record highs.

Alas, all good things must come to an end. 10 years is an incredibly long economic expansion, and now most economists are saying the party will end by 2020 or 2021. It remains to be seen exactly when the next crash will come. However, it would be wise for Canadian investors to start preparing for it now. The following are three strategies to prepare your RRSP or TFSA for a coming bear market in North American equities.

If you're moderately risk tolerant, buy utilities

Utility stocks tend to be among the best performers in bear markets. Owing to their government protected businesses and the "essential" nature of their service, their earnings are relatively stable when times are bad.

Consider **Fortis** (TSX:FTS)(NYSE:FTS), for example. From February 2008 to March 2009, its stock declined just 25%, when most other equities lost about half of their value. If a 25% hit sounds scary to you, remember that it's much better than most stocks fared in the same period.

Fortis has long been considered an oasis in the desert for jittery Canadian investors, owing to its highly resilient dividend, which the company has raised every single year for 45 years — including recession years. However, the stock is not exactly 100% recession proof. Although Fortis shareholders bounced back from their 25% loss in 2009 relatively quickly, such a loss may be too much for some to stomach. If you don't think you'd be able to deal with that, it's time to look at strategy number two.

If you’re extremely risk averse, buy bonds

For the extremely risk averse, government bonds are probably the best pick out there for surviving recessions. T Bills are considered essentially risk free, while interest-bearing Government of Canada securities are darn close to it. Such assets are probably the best safety net for a recession. However, with the interest rate on marketable securities hovering around 1.5%, you won’t get much of a return off them. For that, you’ll want to consider strategy number three.

If you’re average, consider a mix of both

For the vast majority of recession-wary investors, it’s probably best to invest in a diversified portfolio of both utilities and bonds. Utilities will serve the purpose of providing a decent long-term return, while the bonds can act as a buffer against short-term losses in your utility portfolio. Both classes of assets will be affected much less by an economic downturn than say, bank stocks, while offering decent potential long-run returns. For the adventurous, it could also be a good idea to throw a little gold into the mix, whether in the form of physical bullion or gold stocks.

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Author
andrewbutton