Is Your TFSA Ready for a Market Crash?

Description

It's as predictable as death or taxes, and about as fun, too. Yes, I'm talking about a dreaded market crash.

The trouble is always predicting such an event. I can tell you with 100% confidence the market will decline at some point, and that the decline will hurt. The tricky part is figuring out when it'll happen.

I think investors should brace themselves for it happening fairly soon. Certain economic indicators are currently flashing red, telling us a recession is imminent. The last time many of these indicators were this bearish was back in 2007-08, and I don't need to remind you of what happened next.

The good news is by taking a few easy steps today, you can minimize the impact to your TFSA. And remember, you don't have to worry about any tax implications in that account. It lets investors be more flexible.

Let's take a closer look at how you can protect your capital in today's uncertain world.

Add bonds

Bonds are a great addition to any portfolio because they tend to go up as stocks go down. This minimizes the impact a market crash has on your bottom line.

But investors can't just own any bonds. Some will try to add in so-called high-yield bonds to their TFSAs, securities that currently yield 5-6%… or even higher. There's just one problem. These debt instruments aren't safe during tough economic times. They're issued by risky borrowers, which means some will inevitably default.

The way to play bonds is to buy the best. The easy way to do this is to buy Canada's largest bond ETF, **iShares Core Canadian Bond Universe ETF** (TSX:XBB). This ETF contains more than 1,300 different Canadian bonds, with issuers ranging from various levels of governments to blue-chip corporations. After taking off the management fee of just 0.10% of assets, the fund yields 2.8%

annually, which is a pretty solid payout.

One of the nice things about this particular ETF is we can see how it performed during the worst parts of the 2008-09 financial crisis. What we see is very encouraging, with shares bouncing around between $28 and $29.50 during the darkest days. That means the fund did exactly what it was designed to do during the last recession. It'll protect your capital again this time around.

Raise cash

We've all heard of that one investor who is so confident a recession is coming that he's sold everything . He'll buy back in at 20% lower, or so he says.

Don't be that investor. Going to 100% cash is a silly position to take, no matter how confident you are in the next recession.

I propose a less-drastic move. Now might be the time to raise a little cash if you're sitting on some massive long-term winners. Perhaps you sell enough to get your cost out of the investment. Or maybe sell half, letting the rest run.

Say you own **Shopify** shares today, a stock that is up 1,291% over the last five years. Although I'm still a big Shopify bull over the long term — and you should be too — that doesn't mean shares can't tank in the meantime. The stock has a very high beta, which means it'll be volatile no matter which direction the market is going.

If you're even a little bit bearish, it might be time to take some profits on Shopify or big winners like it. Keep those kinds of stocks to a reasonable weighting inside a diverse portfolio.

The bottom line

As mentioned, don't take this opportunity to do anything drastic. You should still have a healthy exposure to equity markets, even if you're confident a recession is coming. It's just too easy to get big macroeconomic predictions like this one wrong.

The simple way to prepare is to get a little more conservative. Sell big winners like Shopify. Use the proceeds to buy boring stuff like bonds. Your portfolio will thank you during the next recession… whenever that may be.

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