Passive Income Is the Perfect Solution for a Bear Market

Description

Some pundits forecast a market crash will occur after the U.S. election in November next year, because Trump will do everything in his power to keep the market up to boost his chances of getting re-elected. That's why some also predict that a trade deal will occur before then. If so, there should be a rally in the stock market.

In any case, a bear market will come for sure — it's just a matter of time and severity — and it will be ugly. In the last market crash, the stock market fell about 50% from peak to trough. And that hasn't happened for a decade!

However, investors need not worry too much. A passive-income strategy is a defensive solution in today's late business cycle and is the perfect solution for a bear market. A solid passive-income strategy has historically outperformed in a bear market and innately helps investors psychologically, as it offers a positive return when built correctly.

Here are some points you should be aware of when building your passive-income stream.

Capital preservation comes first

We're here to build wealth. The first step of which is to preserve capital. Any stock that's speculative, heavy in debt, or ultra volatile is out of the question because, in a bear market, these stocks will be beaten to a pulp. So, avoiding high-flying, high-risk marijuana, turnaround, and contrarian stocks now will save you from a lot of headaches and pain in a bear market.

Quality is the priority

Buying stocks is buying businesses. Stick to quality businesses. Especially in a late cycle (which we're currently in), it's essential to hold top-notch companies.

A quality company should have relatively stable and strong profitability, even in recessions. Moreover, its balance sheet is not weighed down by debt. Therefore, such companies that pay dividends will be able to maintain or even increase their dividends in bad times.

Dividend growth trumps dividend yield

Be wary of high dividend yields of, say, 7% or higher. Typically, companies with yields of 7% or higher grow ultra slowly or are high risk. It’s always safer to hold a company that’s growing its dividend at a sustainably high rate than a company that’s paying a high yield with little to no dividend growth.

Final thoughts

Other than the above points, you can also greatly reduce your investment risk by being very disciplined about the valuation you pay for a stock. For example, you may have a rule to only buy a defensive name like **Fortis** when it’s trading at a discount of at least 15% and only buy an industrial name like **FedEx** when it’s trading at a minimum discount of 50%.

Diversifying your portfolio across quality businesses in different sectors and industries can also reduce the downside of your portfolio in a bear market. Defensive sectors include utilities, consumer staples, REITs, and certain consumer discretionary stocks like **A&W**.

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