Forget Cash! This Investment Has Your Back in a 2020 Bear Market

Description

In an era of rock-bottom interest rates, the opportunity costs of holding cash have never been higher. For overly conservative cash hoarders, the 2010s were, indeed, a lost decade, as the markets continued to defy the bearish expectations of many.

While the next big recession could very well be on schedule at some point in the 2020s, Ben Bernanke, ex-chairman of the Federal Reserve, is of the belief that the Fed has plenty of tools to deter the next economic downturn. And if the Fed can shoot down a potential recession like deflecting a missile in mid-flight, the opportunity costs for overly conservative investors just became that much higher.

Of course, even if Bernanke is right about the Fed's ability to mitigate potential recession risks, the stock market isn't going to be immune from the occasional plunge, like the one that happened in late 2018. As we witnessed in 2018, the Fed can make mistakes, and such errors could have a severe negative impact on stocks. Moreover, geopolitical tensions and other unforeseen events could always trigger a market meltdown at any time, at any phase of the economic cycle.

As such, it's always important to be ready for a worst-case scenario without putting all of your eggs in one basket, either by being a raging bull with 100% of your capital in stocks, or a frightened bear with an overweighting in cash or other low-risk/low-return securities.

By playing both sides of the coin with a risk-parity strategy, one stands to make money, regardless of what the macro picture looks like. Such an approach entails thinking about both downside and upside risks (the risk of missing out on upside) to score the best risk/reward trade-off possible, independent of what you think the broader markets are going to do over the short to intermediate term.

Consider shares of **Fairfax Financial Holdings** (TSX:FFH), one of my favourite risk-parity plays on the TSX Index. It's a great way to play defence and hedge yourself against the next disaster, one that most of the talking heads on TV will likely miss.

Fairfax, an insurer and investment holding company, headed by Prem Watsa, ought to be seen as a "prudent hedge fund" with the use of non-traditional instruments like shorts and swaps to hedge downside risks. Warren Buffett and **Berkshire Hathaway** aren't known for dabbling in such instruments, as they can dampen returns in an upmarket, as we've witnessed over the last several years.

When the sky finally falls, though, firms like Fairfax will stand to be one of few that won't be caught naked when the market tides eventually go out. Watsa's stubborn risk-parity approach is a significant reason why Fairfax was a top performer during the Great Recession, and why it'll be well poised to weather the next big market storm.

I like to see Fairfax as an insurance policy against a market meltdown. And right now, the price of the insurance is absurdly cheap, even given recent jitters that have been sending gold prices creeping higher.

While Watsa is technically more "bullish" than he's been in the past, he's still all about mitigating risks and considering the bull and bear scenarios that could unfold. The man has a talent for spotting macroeconomic trends, but even he is humble enough to know that there's a chance that he too can be wrong.

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