TFSA Investors: How to React to a Market Crash

Description

Tax-Free Savings Account (TFSA) investors are a smart bunch. Permanently protecting your capital from taxes is an opportunity that's too good to pass up.

When markets plummet, however, TFSA investors can get hit just as hard as any other investor. Protecting your money from taxes isn't an advantage when your portfolio is cratering in value.

Yet bear markets consistently create golden opportunities. Some of the best deals of the century could be had during the 2008 financial crisis. Expect similar deals to appear due to the coronavirus crash.

How can TFSA investors protect their portfolio *and* capitalize on the downturn? Here are two simple rules for success.

TFSA investors must prepare

Everyone wishes they were better prepared when a downturn occurs. Investors suddenly feel less wealthy than just a few weeks ago. As stock prices get cheaper and cheaper, most people don't have the cash to keep buying.

The biggest advice for TFSA investors isn't even directly related to investing. Before looking at which stocks to own, take a full accounting of your financial life. While this might sound boring, it's the most effective thing you can do to improve your long-term financial success.

Analyze your life like an accountant would. Tally up your assets and your debts. Separate your assets into liquid assets (things that can be sold quickly) and illiquid assets (things that take weeks or months to sell).

Keep a spreadsheet of all your debt obligations, noting the monthly payment, expected term, and interest rate. Then estimate and total your normal monthly expenses, including food, rent, transportation, and entertainment.

As I mentioned, while this might be boring, you can’t make any financial decisions without having this information in one place.

The next step is to identify your weaknesses and strengths. If your liquid assets cover only a few months of debt payments, for example, a loss of income could torpedo your financial well-being. On the other hand, you may identify areas of your monthly budget that can be trimmed painlessly in an emergency.

Why is all of this information important for TFSA investors? Because the most valuable action you can take during a bear market is to continue buying at bargain prices.

Be prepared to keep buying

Investing can be counter-intuitive. When your portfolio falls in value, the stocks you bought earlier are now cheaper. That’s a great deal. It’s like going grocery shopping and realizing that everything is marked 30% off.

In the grocery store example, you’d likely be ecstatic. But in the stock market example, many investors *stop* buying. That’s a huge mistake.

There’s a reason why bear markets can happen so suddenly. Investors and institutions see their assets fall and are often forced to sell to raise cash. This only exacerbates the problem, however, leading to a negative feedback loop that forces prices lower and lower. Few investors are prepared to buy, but those that can usually secure the deals of a lifetime.

It’s a new year, and unless you’ve contributed already, you may have $6,000 in potential contribution room to use up. If you skipped previous years, you may have even more space, as unused TFSA contribution room rolls forward.

Getting your budget in order is the best way to ensure you have liquidity to keep buying, even as millions of other investors are forced out of the market.

During a bear market, TFSA investors can buy high-quality stocks that will deliver spectacular returns for years to come. In order to do that, you need to ensure you have the cash flow to execute.

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