1 Easy Strategy to Survive the Next Stock Market Crash

Description

Stock market crashes are natural phenomena that each of us will experience usually more than once during our investing lives. We can't predict them with reasonable accuracy. We often try, but can't perfectly insulate ourselves from their disastrous and devastating effects, especially if they swiftly come upon us as the global COVID-19 pandemic did in 2020. However, it's our actions before, and during the stressful events that damage our financial health the most.

Be careful what you do during a stock market crash!

Stock market crashes can set us back many long years on our retirement plans. Unfortunately for some, sharp declines in portfolio values mean delays to planned retirement dates or a return to work for early retirees. But this mainly applies to those in or near retirement.

The worst action one can take during a stock market crash is to sell positions at the dip. All hopes of recovering from losses will be gone. The investment losses will hurt forever, and more so when other investors who held through the bad times start enjoying recoveries.

I advised against this big investment mistake on February 29, right at the onset of the 2020 market crash in North America. Investors don't necessarily have to lose money during a market crash.

Watching paper losses hurts our emotions, but holding positions through market turbulence was the best action to take during all documented past recessions.

The worst drawdown that the **S&P/TSX Composite Index** recorded during the 2020 market crash was 37.4% on March 23. Canadian stocks have recovered much of their early losses.

Although the main equity index is still down 13.5% from its peak early this year, the picture looks much better. Many investors can survive such a short-term setback.

However, the same can't be said about those who sold off their stock positions during the dip in March and April this year. Market crises are usually short-lived. Be careful not to panic sell your loved companies during periods of short-term volatility.

How to avoid selling during a 2020 market crash

Holding onto stocks during a market downturn will require nerves of steel. There’s always the chance that prices can go even lower, and we feel like the sky is falling.

We therefore need to devise a portfolio construction approach that helps calm our nerves during a crisis. The end goal is to allow us feasibly hold stocks for the longest term.

My advice is to separate our investment portfolios into buckets. Each bucket has its financial goal, time horizon to achievement, and a unique risk profile acceptable for each asset we throw into the bucket.

Create separate investment portfolios

Recent studies in behavioural finance reveal our emotional and mental biases and cognitive imperfections. The fear of failing to meet financial goals as they fall due can drive us into a panic mode during stock market crashes.

It helps to separate our investment portfolios into risk buckets. Specific assets will be allocated to each sub-portfolio according to their risk and potential return attributes. Bonds, GICs, real estate holdings, stocks, private equity, and even art have their respective proportions in each bucket.

A child’s university education fund could be set up with a college start date in mind. Initial savings for a down payment on a first home purchase can be placed in an RRSP account as discussed here. The same portfolio could accept savings for long-term education for two spouses.

Money for critical and immediate personal expenses should be placed in low-risk near-cash accounts to minimize short-fall risks, leaving plenty of room for higher investment risk adventures elsewhere.

A separate long-term retirement portfolio will then assume all the high investment risks the stock market will throw at us. Since this portfolio has a long-term goal, we can afford to hold positions during market crashes. The knowledge that markets usually recover in the long term will help us sleep well at night.

With a bucket approach, it won’t be necessary to emotionally panic sell stock positions in retirement portfolios.

As long as retirement dates are still far away, we have the luxury of waiting on the economy to recover. And the stock market usually recovers with the economy, so surviving can be a little easier.

CATEGORY

1. Coronavirus
2. Investing

PARTNER-FEEDS

1. Business Insider
2. Koyfin
3. Msn
4. Newscred
5. Sharewise
6. Yahoo CA

Category

1. Coronavirus
2. Investing

Date
2025/08/26
Date Created
2020/06/17
Author
brianparadza