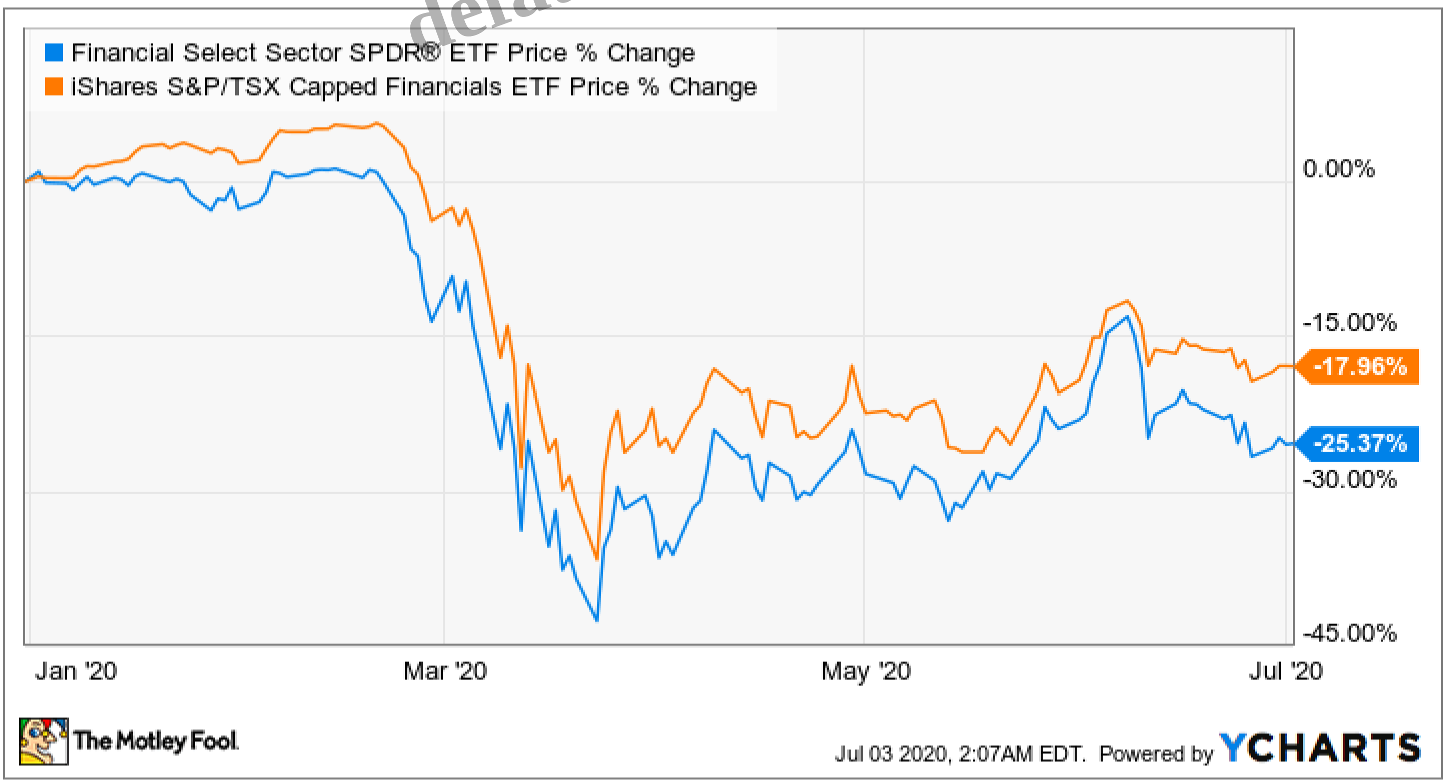
Warning: How to Prepare for a Market Crash in July

Description

There have been renewed COVID-19 outbreaks in geographies that are reopening too fast, too soon. On news of reopening, some people have gathered in crowded places like beaches with no masks on.

Virus disruptions, protests, trade wars, and high debt at the government, corporate, and household levels translate to a bleak economy in the short term. The year-to-date selloffs in the U.S. and Canadian Financial exchange-traded funds (ETFs) shown below illustrates a crippled economy.



*XLF data by YCharts. The year-to-date chart of **iShares S&P/TSX Capped Financials Index ETF** and **Financial Select Sector SPDR Fund**.*

The top five holdings of the Canadian financial ETF are **Royal Bank of Canada**, **TD Bank**, **Bank of Nova Scotia**

, **Brookfield Asset Management**, and **Bank of Montreal**.

The U.S. financial ETF's top five holdings are **Berkshire Hathaway**, **JPMorgan Chase**, **Bank of America**, **Citigroup**, and **Wells Fargo**.

These stocks are sensitive to the economic cycle. This economic contraction will weigh on the sector and the stock market as a whole. Even pockets of shutdown economies in key cities can have big impacts on a country's GDP.

Investors might as well prepare for a market crash in July. The earlier you are ready, the better.

Mental preparation

Investors should prepare their minds by visualizing their stock portfolios being shaved in half. If you hold a $100,000 stock portfolio, it'd mean visualizing it as $50,000.

In fact, certain areas of the stock market, including retail REITs and oil and gas producers, have fallen that much, if not more.

Of course, ideally, you'll want to avoid these underperforming areas *before* they fall. And perhaps you'll buy selective stocks *after* they've fallen.

Long-term investors know that it's impossible to bat home runs all the time. Even the greatest investors can't bat home runs for every investment. Therefore, this is a good exercise to do periodically.

Invest in dividend stocks

It's always a riskier endeavour to trade stocks for short-term gains than investing long term. In today's choppy market, it's even more difficult to make quick trades.

Investing in dividend stocks encourages investors to invest for the long haul, because they must hold shares to receive dividends. When holding safe dividend stocks, investors can stay invested in the stocks forever if they want to, because they can enjoy the fruits (dividends) without having to sell.

By getting safe dividend income from stocks like **Fortis** and Royal Bank, you can invest through market crashes with no problem. Just make sure you don't need the money for at least the next three to five years.

Hold a meaningful cash position

Another benefit of holding dividend stocks is that it can help you build a cash position in a highly uncertain market.

How much cash should you hold? It depends on how comfortable you're in the current market, your portfolio allocation, and the attractiveness of stocks you're interested in buying. At any time, investors could have cash positions of 0-30%.

The more uncomfortable you are with the stock market, the more cash you might consider holding. However, don't hold too much cash for too long, because its returns are close to 0% due to low interest rates.

If stocks on your buy list reach your target buy ranges in a market crash, you can consider deploying some of that cash.

Invest in growth stocks

Some growth stocks have done amazingly well recently, including **Amazon** and **JD**. Both stocks recovered swiftly from the March crash. Some might even argue that there was no crash for JD.

Investors should consider holding some solid growth stocks as a part of their diversified portfolios to combat market crashes and for long-term wealth creation.

The Foolish takeaway

Always be ready for a market crash. If you don't have a plan yet, think of one now. Ideally, you should have an investment plan that works well through economic cycles.

For me, that means employing largely a value and dividend investing strategy and investing in a group of stocks that I'm familiar with.

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Date
2025/07/29
Date Created
2020/07/05
Author
kayng