Market Falls Predicted - Ways To Protect Your Investments

Well, it seems markets are falling everywhere.

The FTSE100 is at 7300 as I write, down from a high of over 7600, with American stocks not far behind. Investors are starting to worry as signs point to another recession.

The latest worries stem from a bond market phenomenon known as “yield curve inversion” where the yield on the British and American governments’ 10-year bond falls below the yield on its two-year bond - See my article on the Inverted Yield Curve here.

This ‘inversion’ is invariably a sign of a recession in the near future, because it means shorter-term interest rates need to fall to balance out, which happens when economic activity slows.

However, despite the market falls, it’s important to remain calm and avoid panic reactions.

Whilst an ‘inversion’ suggests recession, the timing is not predicted, and it can be up to 18 months down the line.

Also, recession does not necessarily mean stock markets will fall. Recession and declining stock markets are, of course, related, but surprisingly, the connection is not really that direct, and both are a normal part of economics and investing.

Given how far markets have risen since 2009, a downturn in both the economy and the markets should not come as a surprise.

However, no investor wants to simply accept the value of their investment going into reverse. Here are some ways to organise your investments and get ahead of changes in markets.

Do not Shift into Cash!

Often an investor's first instinct is to sell equities, and hang onto cash. This has its merits, as it means you limit your losses if markets continually fall, but there are important downsides to think about.

First, it’s hard to know what is ‘a bit of a correction’ and what is going to be a prolonged market fall.

Selling out too early will simply incur costs and means you miss a rally.

Second, when you hold cash it means you are not invested when the bear market comes to an end. The subsequent rise in markets is often the most lucrative in its first few weeks, but sit on your cash and you will miss out.

Staying invested in markets through downturns may seem illogical, but had you invested in the British stock market the day before Lehman Brothers collapsed, often cited as the start of the 2008 financial crisis, by today your investment would still have risen some 48pc.

Shift into Different Stocks

Investors can use the period before a recession to change the types of assets they own.

Investors could benefit by shifting from the equities that have done well and are most susceptible to share price falls, such as US techs, into defensive companies.

These tend to be companies whose profits and performance are not affected by an uncertain economic environment and can make money regardless.

Defensive stocks, generally consumer staples, can see better share price performance than the market during falls as they are better placed to maintain profitability during an economic downturn.

However, these stocks can be expensive. Diageo, the maker of Guinness and Johnnie Walker, is a classic defensive stock but its shares currently trade at a price-to-earnings ratio (a popular measure of value) of 25, while the wider London market trades much more cheaply at 14 times earnings.

In times of need, however, paying over the odds to protect your portfolio can be a necessary evil.

Shift into the Right Funds

There are funds which invest across a range of assets, are designed to be defensive and protect the value of money when markets get rough.

These portfolios have built in a significant degree of protection against the ups and downs of the markets, but investors must sacrifice some long-term growth potential in return.

These are particularly useful for cautious investors who do not want to see their hard-earned savings potentially halve 'overnight'.

Buy the Dips

No, not those dips!

Falling markets naturally seem like a bad thing, but they also offer a real opportunity for the savvy investor to buy assets at a cheaper price than their true worth.

Investors willing to hold some cash can take the risk and drip feed money into markets picking up cheaper assets along the way.

This strategy will reap its rewards when markets turn and once-fearful investors pile back in pushing up share prices.

Do Nothing

Despite all the panic, often the best decision is to ignore everything. Markets naturally rise and fall and even a 40% fall in the stock market over the course of one month will be insignificant over a 20-year period.

If you are investing for the long term, such as your retirement, and have no need for your money, simply sit back and ignore the noise.

Anyone who had money invested in global stock markets before the financial crisis has more than made their money back by now. Doing nothing can often be the easiest and best solution.