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FINANCIAL STRATEGIES FROM
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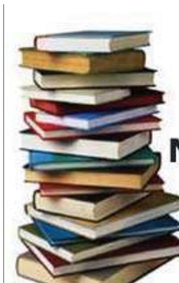
How to Be Defensive in a Falling Stock Market

It is the end of 2008 and the stock markets continue to fall. World-wide stock markets have now fallen more than 50% on average (source Globeinvestorgold).

With markets poised to continue to fall, and with housing values also dropping and some people even facing unemployment in a shrinking economy, an individual's mind turns to defense and protection of capital. Let's examine a variety of ways to be defensive in these tough times:

- If you have a financial plan, have faith and stick to the financial plan, as it has been built giving consideration to market volatility. While this may prove to be the mother of all recessions and lasting several years, it will end and then the markets will roar back and go higher than they ever have before. It is just a question of when. This is how it happened ten other times in the last 50 years, with the last major correction as recent as 2001 and 2002 when the TSX dropped 43% (source The Globe and Mail), only to see the same TSX go straight up for the next five years. This too shall pass, but as with all stock market investing, you need to have a five year to ten year time horizon to invest in the stock market in the first place. If you do have this time horizon, try to focus less on the day to day "noise" you are hearing today and focus on your bigger picture perspective.
- When a market falls day after day, it may go beyond your tolerance in the end. And, no matter what wise investing says, it may be time to sell and move to cash for awhile. It's ok to do this. First, understand what your level of loss is. Second compare it to your maximum tolerance, perhaps - 50% if you are younger or - 25% if you are older. You need to decide at what point your gut says that preservation of capital matters most, no matter what. When you reach that point, for your own health, call the office and place the sell orders. It will only take a minute.
- Rather than selling everything you hold in the stock market, a second option is to take steps to trim gradually. As the market continues to fall, continue to sell parts of your equity products over time. This week sell the global equity products. Next week sell the Canadian equity products. And so on. Using this gradual approach will allow you to keep a toe in the stock market longer and if it turns around, you will be in a position to benefit from the entire rise. But it does allow you to take increasing pro-active steps to "sell down" your stock market exposure until there is none left, it if comes to that.
- I can't write an article about defense and not mention gold. In the past, gold has been viewed as a safe haven in the world in times of economic turmoil. Many money managers today have moved money into gold expecting it to rise in value as the stock markets fall. Interestingly, gold has not risen and in fact it has fallen during these times. This may mean that in the 21st century, gold is no longer viewed as a hedge against a falling market and can no longer be relied upon for stability during times of turmoil. It appears that we cannot recommend buying gold to offset your losses as it has not produced the desired results so far in this correction.
- If you have loose cash you can purchase inverse stock market products such as Horizon Beta Pro Bear TSX 60 units. These are stocks that trade on the Toronto Stock Exchange and offer a rising return based on the falling of Toronto Stock Exchange stocks. As the market falls, these products rise at double the rate. You can buy these products for the Canadian stock market, the Canadian dollar, the US Stock market, energy and more. Learn more at www.hbpetfs.com. Buying a few of these products alongside your regular investments neutralizes the decline of the market by offsetting the falling products with new products that rise at the same or faster rate. Once the stock market stabilizes you can then sell the Horizon products to remove the hedge and allow your existing products to recover.



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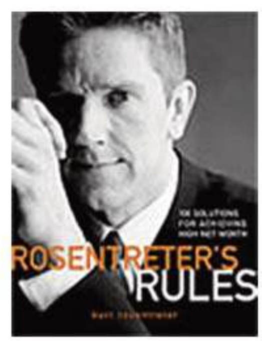

- Switch your stocks, indexes and equity mutual funds to life insurance segregated funds. “Seg funds” cost approximately 1% more than the average mutual fund costs per year, but offers a guarantee of your original capital over a ten year period. Switching to seg funds allows you to put a floor underneath your stock market products, but still keeps you in the stock market and in a position to recover in the next few years. If the market continues to fall, you are guaranteed to get your original money back. If the market rises, you will get the benefit of the rise.
- If you are retired, buy a performance annuity for guaranteed income with stock market upside. An annuity is an insurance product whereby you provide a lump sum of money now in exchange for a regular income payment every month for the rest of your life. A minimum payment is provided. If the stock market rises, your payment may rise to reflect this rising value. If the stock market falls, you continue to get the minimum payment amount.
- Switch your equity products to defensive stock market sectors that should be able to ride through a stock market correction with less of a fall. Specifically, move into sectors where consumption does not change in a recession: food stocks, pharmaceutical stocks, drug and liquor stocks – these are all products that people need or use whether they have a job or not.
- Consider some of the new guaranteed minimum withdrawal benefit products in the market now, which provide guaranteed cash flow of 5% for life and the ability to lock in stock market gains over your lifetime without ever facing stock market losses. These products combine the benefits of annuities and seg funds to create a guaranteed lifelong income stream with no downside risk in the stock markets. Note that these products require a lifelong commitment – you may not want to put all of your wealth into one but consider using them to cover your essential life costs (food, utilities, healthcare) in retirement so you know you always have essential costs paid for – no matter what else happens in your finances.
- If you are still working in your career during this stock market correction, take steps to build up your cash balances in the months to come and also pay down debts. This is a good time to be awash in cash and anyone who is debt free is in a great position to weather a recession better than most. With no debt payment to make you can more easily reign in your spending if needed. Defer non essential spending for a year or two.
- If you are retired, and you don’t have a pension to rely on to cover your key costs, slash your annual spending for the time being. Defer vacations, home repairs, large purchases , giving your kids money, restaurant spending and other non-essential spending in order to reduce withdrawals from your investment portfolio. Try to draw out less in a year where you are earning nothing – avoid depleting capital as much as possible. You can always make up for this in a good year.
- Try to pay off outstanding small debts like lines of credits, investment loans, car loans and credit card balances. Don’t make an RRSP contribution this year – instead hold onto the cash or use the cash to pay down debt.
- Avoid any major real estate moves right now - don’t buy a rental property, a vacation property or a new home. Prices are falling so these may be cheaper in a year. You also cannot afford to end up in a cash flow squeeze if you buy a property and cannot sell your existing property on time or for a value that you expect. Such a large asset can wreak havoc on your cash flow if you get saddled with carrying two properties during a multi-year recession. Equally, if you cannot rent out a rental property, you don’t want to have to carry the property mortgage on your pay cheque during times like this.
- How stable is your career or the career of family members who may lean on you for money if they lose their job? Losing a career may result in a lost income, but may also result in lost pensions, lost dental coverage, you may have to give up a company car and you may be forced to sell stock options at depressed prices. Take time to think about the impact on your finances if you lost your job and what steps you can take now to offset the impact should it occur.
- Go to the bank and apply for emergency lines of credit. Do this now while you have good credit. Leave these lines of credit in place and do not draw on them, but know that you can count on them for emergency cash if needed. Let them sit quietly beneath you as a safety net that hopefully you never need to draw on.

These are historic times that could very well affect the quality of life of every Canadian. It is in your best interest to take defensive measures in the short term. I’m confident that on a two to three year basis the financial system will be back to normal. But that could be a long two years. Be ready for anything but have faith in capitalism in the end. If I can leave you on a up note it is this: let there be no doubt that at some point in the future this may prove to be the greatest opportunity to buy into the stock market in one hundred years.

Contact us to answer your questions, schedule a meeting, get a second opinion, refer a friend, order a book, receive a brochure on services and fees, create a financial plan and more. *MEMBER CIPF.

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