# How to Protect Your Investment Portfolio in a Recession: The Ultimate Guide

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# HOW TO PROTECT YOUR INVESTMENT PORTFOLIO IN A RECESSION: THE ULTIMATE GUIDE

Protecting your investment portfolio can be a daunting task.

However, one can follow some great tips and tricks to protect your investment portfolio and ensure that your investment dollars are safe even in a recession.

This guide explains what a recession is, why protection of your investment portfolio is essential, how you can protect it, and the mistakes you should avoid when investing.

# WHAT IS A RECESSION?

A ***recession*** is a significant decrease in economic activity that lasts for months or even years. Experts proclaim a recession when a nation's economy sees harmful gross domestic product (GDP), increasing levels of unemployment, declining retail sales, and contracting measures of income and manufacturing for an extended time. It's also an inevitable component of the economic cycle or the regular cadence of expansion and contraction in a country's economy.

A recession can also cause investments in stocks, bonds, real estate, and other assets. Business owners may also have lower sales and be forced into bankruptcy.

## WHY DO RECESSIONS OCCUR?

Past recessions have happened for various reasons but often result from ***economic imbalance*** that accumulate and must eventually be corrected.

For instance, the ***1973 oil crisis*** led to the beginning of the 1973–1975 recession. The majority of recessions, however, are brought on by a complicated triad of elements, such as high-interest rates, poor consumer confidence, and stagnant or declining real wages in the labour market.

A sudden shock that is pervasive enough to harm company profitability and lead to job losses, like the present health crisis, can also be to blame.

## WHY PROTECTING YOUR INVESTMENT PORTFOLIO IS ESSENTIAL.

Another recession is almost inevitable, and it's just how the world, economy and finances work. And the question is not whether but rather when.

Sadly, many investors have no plan or don't know that protecting their portfolios is essential.

In times of economic unrest, investors should prioritise the long term and stick to their investing strategies. It's a tricky game to invest in equities and time market downturns if you don't know what you should support. Protecting your investment portfolio in a recession can help you find the best opportunities once you know which investments perform well.

# FOUR SIGNS A RECESSION IS COMING

Here are four signs to watch out for to know when a recession is coming.

## 1. Employment Data

***Unemployment and recession*** appear to go hand in hand. Many people's first recession experience is unemployment because they have been fired or can't find work.

Unemployment results from recessions, as people also have less money to spend on goods and services if they lose their jobs. As a result, a recession in one area of the economy can lead to unemployment, which can lead to another recession.

In the UK, the ***unemployment rate*** increased slightly from 3.7% to 3.8% in the three months ending in April 2022, exceeding estimates of 3.6%. The number of people who have been out of work for up to six months has increased since late 2020, although full-time employment has hit an all-time high.

This is the first increase in the unemployment rate since the final three months of 2020. The number of paid workers increased by 90,000 to a record 29.6 million in May, and the number of open positions from March to May 2022 grew to a new high of 1,300,000. The rate of increase in vacancies did, however, keep slowing down.

## 2. Gross Domestic Product

Although less precise, the output gap between the economy's current and potential gross domestic product (GDP) is still worth tracking. A possible impending recession can be predicted when the output gap between the actual and potential GDP increases.

## 3. The housing market

The ***effects of recessions*** can be felt throughout the economy, from employment to expenditure to stock market movement and even real estate.

High mortgage rates can discourage buyers, but how the real estate market is affected depends on the effect on demand and affordability.

*Image Source*

## 4. The economic cycle

During recessions, the demand for products and services begins to fall rapidly and continuously. Producers don't notice the decrease in demand instantly and go on producing, which creates a situation of excess supply in the market. Prices tend to fall, and all positive economic indicators such as income, output and wages start to fall during a recession.

# THINGS INVESTORS CAN DO TO GET THEIR PORTFOLIOS READY FOR A POTENTIAL RECESSION

While we can’t control whether a recession will occur, there are some things you can do to increase your chances of surviving.

Here are ***five things*** you can do to prepare your portfolios for a potential recession.

## Don't rebalance just yet.

Rebalancing your portfolio, which is purchasing and selling investments to return to the original mix of stocks, bonds, and other assets, is a brilliant idea, but not when the market is in a downturn.

Try your hardest to hang onto your investments when things are looking bleak. One of the worst things you can do for your portfolio is selling at a low market since it locks in losses. Rebalancing can be necessary when the market eventually reaches equilibrium.

## Buy the dip

If your financial situation is stable enough to allow you to purchase during a recession, you may be positioning yourself for future success.

*Image Source*

Choose a few investments you've always wished you owned and choose a price range you're happy with. You may obtain a deal if they fall to or below that level. However, avoid hedging your bets in a turbulent market if you're already struggling financially or fear losing your job. An emergency fund is a better use of your money than a risky investment. Try to buy the dip only if you can afford to lose the money.

## Remember why you picked your investments.

Ideally, you picked your investments for diversification. Spreading out your investment assets reduces risk in the same way that placing all your bets in one location increases the likelihood of losing money.

Allocating your funds among various investment types, such as stocks and bonds, is not the only way to diversify your portfolio. Additionally, it implies that your funds are distributed among numerous sizes of businesses, regions, and industries. Although this is crucial, careful diversification can help keep you safe during a recession. When considering buying the dip, consider investing in items that will diversify your portfolio.

## Invest in the essentials

Investing in essentials like utilities is a classic lower-risk investment. Even during a recession, there will always be a need for the service utilities offer.

Because ***utility stocks*** are less volatile than the rest of the market and offer fewer opportunities to profit quickly, investors and traders are typically not interested in them. However, they're one of the few industries where investors can safely save money during a recession. Utility stock prices were stable compared to other sectors, dropping by double digits or into negative territory.

## Stay invested if you can

Try not to get alarmed by the alarming headlines, and remember that the best course of action is almost always to stay invested.

According to experience, investors who remain supported throughout recessions see their portfolios fully recover, while those who choose not to participate end up losing their money.

# HOW TO PROTECT YOUR INVESTMENT PORTFOLIO IN A RECESSION

Here are eight things investors like you can do to protect your portfolios from a potential recession.

## Stay invested if you can

Being realistic about the market and your portfolio includes understanding ***what type of investor*** you are.

First, remember that there are still ways to make money even during a bear market. Some investors short-sell stocks to profit from declining stock prices, which allows them to gain when share prices drop and lose when share prices increase.

However, only experienced investors should employ this method due to its pitfalls. The most significant is that since there is no evident upper bound on how high a stock's value might grow, short-selling losses are theoretically unbounded.

Another investor approaches a recession like a sale at their neighbourhood department shop.

Value investing is a strategy that views a falling share price as a deal just waiting to be snatched up. They use bear markets to buy high-quality companies cheaply, betting the economy will eventually experience better times.

Another kind of investor scarcely even blinks during a recession. Short-term issues won't even register as a blip on the chart over a 20- to 30-year timeframe, according to a proponent of the long-term buy-and-hold approach.

## Diversify Your Portfolio

***Diversification*** spreads your investments around so that your exposure to any one type of asset is limited. This strategy is designed to help reduce the volatility of your portfolio over time, balancing risk and reward in your investment portfolio.

Diversification is essential when preparing for a recession.

In ***diversifying your portfolio***, try a portfolio of investment pairings that aren't significantly correlated, meaning where one goes up, the other goes down, and vice versa (like stocks and bonds). This implies that you should consider asset classes and stocks in businesses unrelated to your career or primary source of income that will help you be in a better position to endure a downturn.

## Proper preparation and a long-term outlook

Proper preparation includes ***reviewing your budget*** and looking out for the long-term.

Ask yourself, "How much do I need to earn to pay my bills and cover my essential spending?" This is your primary income required, and you should ensure you can continue to produce this amount.

If you're married, consider how your finances might change if one of you loses your work. If your funds are tight, look for places to reduce your expenditure, bills that can be dropped, or loans that can be refinanced.

Additionally, you can consider starting a business or side hustle to generate passive income later on or seek for side jobs to diversify your revenue streams.

## Stay away from conventional investment.

Conventional investments include stocks, bonds, and cash.

Meanwhile, ***alternative investments*** include private equity or venture capital, hedge funds, commodities, art and antiques, derivatives contracts, and real estate.

Alternative investments usually have a low correlation with those in standard asset classes. This low correlation means they often move counter to the stock and bond markets, which makes them a suitable tool for portfolio diversification.

Investments in hard assets, such as oil, gold, and real estate, also provide an effective hedge against inflation.

## Calculate your risk tolerance and your asset allocation

Before investing, ***assess how much risk*** you can tolerate.

A good rule of thumb is to have a reduced proportion of risky assets in your portfolio as you get closer to retirement. You can take on greater risk if you've recently entered the job market in your 20s because you have time to recover from market downturns.

## Put Options

While it might seem surprising, ***some industries*** perform pretty well during recessions. Stocks from a few of these recession-resistant industries are frequently added to portfolios by investors searching for an investment strategy during market downturns.

The top investments usually come from the following sectors: consumer goods, grocery stores, bargain retailers, manufacturers of firearms and ammunition, alcohol manufacturers, cosmetics, and funeral services.

## Investing in dividend-paying stocks

***Investing in dividend stocks*** is an innovative strategy to create passive income even during a recession. Some experts advise looking for companies with low debt-to-equity ratios and solid balance sheets when considering dividend stocks.

## Build Cash Reserves

Finally, you should always keep a little money in savings accounts.

*Image Source*

As compound interest builds up, cash will still produce a modest return and reduce your portfolio's volatility, bringing you comfort and avoiding irrational choices. The ability to buy deals when the downturn slows will be made possible, most critically, by having cash on hand.

# MISTAKES YOU SHOULD AVOID WHEN INVESTING DURING A RECESSION.

Here are five mistakes to avoid when investing during a recession.

## Maintain a long-term perspective

When the market declines, it can be easy to sell or stray from your long-term investing plan. But it's more crucial than ever to adhere to a solid long-term plan if you have one.

"Maintain your investment strategies," advises Kenneth Chavis IV, CFP, senior wealth manager at ***LourdMurray.*** "Rebalance, extract tax losses where you can, and keep dollar-cost averaging into your retirement plan vehicles."

## Not diversifying

It's always advised to ***have a diverse portfolio*** to protect your money from losses and economic downturns.

Depending on your level of risk tolerance and financial objectives, a mix of secured bonds, stock investments, and tangible assets can help you achieve long-term development.

Varying investment types come with different risks and returns. High-risk investments typically offer higher returns, and low-risk investments yield lower ones.

Diversification leverages low-risk assets to preserve your portfolio and maximise returns from high-risk, high-reward investments.

In general, leaving your investments alone will yield the highest returns. This is particularly true during recessions when selling stocks out of panic can cost you money, while keeping your investments in place gives the market time to recover.

## Becoming a Co-signer

Even during thriving economic times, ***cosigning a loan*** can be an extremely risky commitment. The co-signer could be forced to make the payments if the borrower can't do so. The dangers of cosigning a debt increase during a recession since both the borrower and the co-signer may be more likely to lose their jobs or see a drop in business income.

However, regardless of the economy, you could need to cosign for a relative or close friend. In such circumstances, it pays to have some cash set up as a safety net. Or, rather than putting yourself on the hook for the cosigned loan, it might even be wiser to help with a down payment or make a personal loan instead of signing.

## Investing your emergency fund or short-term savings

Only invest money you won't use for ***at least five years.*** Keep the money you're saving for short-term goals and an emergency fund in an account that's easy to access.

Investing in your short-term savings is risky since you might have to sell your investments at a loss if you need the money at a specific time, especially if a recession is on the horizon. It would be best if you didn't risk your savings this way, even in prosperous times.

## Sell everything when the market is down.

Many investors experience panic during a recession, significantly if they are investing on their own without the responsibility of a financial planner or advisor.

Selling investments when the market is down is often a ***reaction to fear***, which can be detrimental to investors over time when the market corrects itself.

Try dollar-cost averaging instead, where you consistently invest the same money. Sure, you'll buy stocks when they're high, but you'll also buy them when they're "on-sale" at their lows, which eventually balances out your costs.

# SUMMARY

An economic slowdown need not cause panic, but you should be extra cautious with your expenditures and avoid taking unwarranted risks.

You can take many constructive actions to improve your condition and recession-proof your portfolio and your life even amid a severe economic crisis.

I hope this guide helped you in understanding investment and recessions.

# Interested? Talk to our team

If you have any questions or concerns, you may ask and ***schedule an appointment with us todays.***

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