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STOCK MARKET

# Can you really prepare for a market crash?

Imagining a few what-if scenarios should help navigate the elements of surprise in the markets, advisors say.

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Investors can't be blamed for feeling nervous about the market's recent volatility. The violent ups and downs have many people wondering whether they should take action with their investments to prepare for a sustained drop in stock prices.

The message from investment advisors, however, seems to be: If you plan ahead, and periodically rebalance your portfolio, you won't be stressed out and make unfortunate panic moves.

"I don't know where the markets are heading. I don't fret about it and neither should investors," says Adrian Mastracci, senior portfolio manager at Lycos Asset Management in Vancouver.

His view is that being fully prepared for any outcome is wise investing strategy, regardless of when a market crash becomes reality – and how long it lasts.

Mr. Mastracci says fretting and worrying about volatility does not help. "Market mayhem is a normal occurrence, in all directions. Investors will often have little time, if any, to react," he says.

One tool he finds helpful is to sketch out what clients may do when markets significantly fall back or advance. "A few what-if scenarios should help navigate the elements of surprise."

These scenarios are part of an overall long-term investment strategy, which Mr. Mastracci sees as the key to effective financial planning – and investor peace of mind.

The central focus of the investment strategy should be on asset allocation. Studies have shown that asset allocation has by far the greatest impact on portfolios – not stock selection or market timing. Asset allocation is the relative weighting of asset classes, such as cash, bonds and stocks.

Mr. Mastracci calls market timing – that is, selling stocks before an anticipated drop, with the expectation they can be bought back later, more cheaply – a "low percentage strategy." Asset allocation has a far higher chance of delivering results. "That is why I make it my focus," he says.

A key part of an asset allocation plan is to periodically rebalance portfolios so they return to their designated weightings. Investors who have been following this strategy have been selling some of their stocks and equity-based funds from time to time over the past few years as markets rose, and putting the proceeds into underperforming asset classes such as bonds.

This process has insulated them from overexposure to one sector, which can hurt when market volatility strikes. It also becomes a natural (and automatic) way to sell high and buy low.

"Learning to take some occasional profits is sound strategy," says Mr. Mastracci. "The flaw is that the majority of investors have not set the initial asset allocation targets. Hence there is no yardstick to measure up to."

The importance of asset allocation and rebalancing is a theme for other advisors as well.

Greg Newman, a senior wealth advisor, director and portfolio manager at Scotia Wealth Management in Toronto, suggests a number of ways investors can protect themselves against major market drops.

Among them is holding cash and bonds in your portfolio and owning investments that generate income (such as dividends) so the portfolio's return isn't solely dependent on equity prices going up. Mr. Newman is also a fan of dividend reinvestment plans (DRIPs) that automatically use dividend payouts to purchase more of the same security.

More sophisticated investors use advanced techniques to protect investments. These include options instruments such as puts and calls to guard against market drops, though these can be expensive and complicated for most people.

Mr. Newman illustrates how portfolio rebalancing can help protect investors. He uses a simple example – say a portfolio begins with a planned 50/50 mix between equities and fixed income. As the stock market rises, and if the investor regularly rebalances, when the inevitable market correction comes she or he will take a direct hit on just half the portfolio, rather than a potentially greater share.

Individual investors can do a number of things to protect themselves against major market drops, says Allan Meyer, a director and portfolio manager at Wickham Investment Counsel in Hamilton.

Investors can sell some positions and increase their cash holdings, buy bonds, or just stay in high-quality stocks and "ride through the drops," he says. More exotic techniques such as options, inverse exchange-traded funds (ETFs) and taking short positions in stocks "should be left to the pros," he says.

His other tips include avoiding new stock issues (IPOs) as they don't have a track record, and resisting the pull of speculative securities such as cannabis and cryptocurrencies.

Mr. Meyer is also not a fan of trying to time the market. Getting the timing right for both the selling and buying is a significant challenge. "I don't know of anyone who has been able to do it successfully and consistently," he says.

Mr. Meyer believes portfolio rebalancing is a key way to help investors at all times, including reducing losses in market downturns. "Rebalancing forces you to do some selling at the highs and enforces a discipline that is missing in most portfolios," he says.

Portfolio rebalancing is important, but it really only works if you have an overall investment plan. "It's hard to move the yardsticks if they are not set," says Mr. Mastracci.

But he believes setting those targets, and sticking to them, is not really that difficult, because most investors are comfortable with a balanced portfolio approach that will see them through the market's ups and downs.