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Ways to Protect Your Investments on Huge Market Drops

DISCLAIMER - I am not a Financial Advisor and do not work for any Brokerage Firm. The opinions given are of my own and are not to be used as professional advice. These are my findings and can hopefully help you to make informed decisions on investing. Consult a Broker or Lawyer before making any investment.

One of the reasons many people refuse to invest is the fear of loss. It is real, and I understand your feeling. Anyone who says that big market drops do not bother them either has very little in the market or the money is of little significance to them. I preach the wisdom of riding out the market bumps with the ebbs and flows. And for all the bull markets we have seen, they are always followed in time by a bear market.

If you are unfamiliar with those terms, a bull market means stocks are going up the majority of the time, whereas a bear market is when the stocks are dropping most of the time. Trying to time the market is very difficult. I tried a few times and found that most of the time I was either

late in selling or waited too long after the bottom to buy back in. Typically when the market rebounds, it is by 1,000 to 2,000 points. So on those days, you want to be invested to gain the most traction and good returns.

I have tried to take the buy and hold strategy the last few years, and have done well. However, a huge drop in the market could throw a wrench in your plans when you reach your retirement years like me. The reality is that a huge loss would be very difficult in which to recover. A young person can lose a lot and still come out in the long term. So this article is geared toward you that are in your 50s or older. However, some of the strategies might be wise even for the younger audience due to the current market. Below is the method I have for years recommended.

This article from Fidelity came out in June urging people to stay the course even in the choppy markets.

Fidelity shows that people churning money in and out on a whim rarely break even with the people who continue to buy when everyone else is panicking.

Here is an excerpt from that Fidelity article:

Stick with your plan, even when markets look unfriendly

When the value of your investments falls, it's only human to want to run for shelter. But the best investors don't. Instead, they maintain an allocation to stocks they can live within good markets and bad.

The financial crisis of late 2008 and early 2009 when stocks dropped nearly 50% might have seemed a good time to run for safety in cash. But a Fidelity study of 1.5 million workplace savers found that those who stayed invested in the stock market during that time were far better off than those who headed for the sidelines.

In the decade following the start of the crisis in June 2008, those who stayed invested saw their account balances—which reflected the impact of their investment choices and contributions—grow 147%. That's twice the average 74% return for those who fled stocks during the fourth quarter of 2008 or the first quarter of 2009. While most investors did not make any changes during

the market downturn, those who did make a fateful decision with a lasting impact. More than 25% of those who sold out of stocks never got back into the market and missed the gains that followed.

If you get anxious when the stock market drops, remember that's a normal response to volatility. It's important to stick with your long-term investment mix and to have enough growth potential to achieve your goals. If you can't tolerate the ups and downs of your portfolio, consider a less volatile mix of investments that you can stick with.

So the old, proven, continual purchasing whether the market is up or down appears to be a good way to go. The term is dollar-cost averaging. If you buy when the stock is high and sell when it is low guarantees a loss. But if you purchase while the price is down, the average price per share drops. This gives you the ability to make up quickly for any early losses.

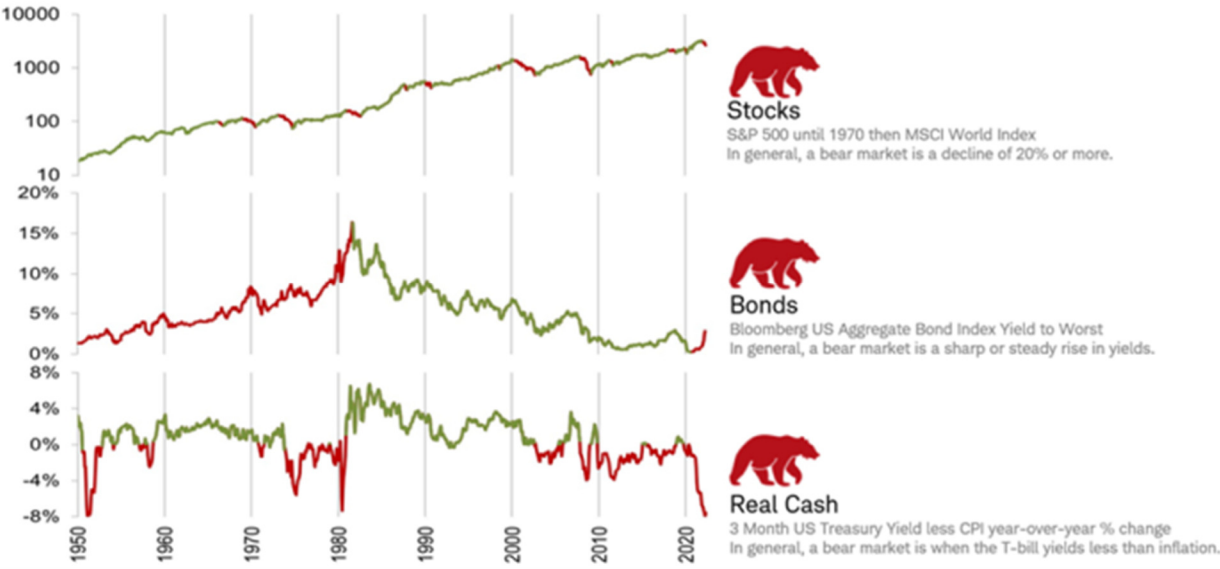
With that being said, let's look at where we are here in August of 2022. I think a little insurance might be wise at this time. The S&P 500 has had a huge drop over the first half of the year. (22% loss.) Normally when these bellwether stocks crater like this, the bonds kick in to offset some of the losses. If your portfolio was like mine, the bonds lost from 2 to 5% making this a horrible year. I read an article from Schwab 2 months ago and they explained that this is only the third time in the history of the stock market that stocks and bonds went down at the same time. Here is that article:

THE THREE BEARS

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Stocks, bonds, and cash are all in a bear market or teetering on the edge of one—a very rare event. Over the past 72 years, there have only been two periods with a triple bear—both took place in the 1970s.



- On Friday, the S&P 500 and MSCI World Index both briefly slipped into bear market territory before recovering by the end of the day, closing very near the -20% threshold from the market peak on January 4, 2022.
- U.S. bond yields have jumped in 2022, posting their worst start to a year on record. Other bond markets around the world have also performed poorly. The trend in German bond yields reflects the U.S., trending lower since the early 1980s until recently. Both the U.S. and German 10-year bonds have suffered a loss of just under 10% on a total return basis so far this year.
- The return on cash, represented by three-month U.S. Treasury bills, has been lagging inflation, resulting in a negative return on an inflation-adjusted (or real) basis for many years. The surge in inflation over the past year has pushed the real return deep into negative territory, similar to where it was very briefly in both 1951 and 1980.

Will a bull market return?

A bull market is likely to return, as it typically has. But when? Well, every period is different and there can be no guarantees. It is worth noting however that the prior periods featuring any of these three bears were often very brief.

- Occurrences of cash bear market extremes historically marked a peak in inflation. We may already be seeing signs that inflation peaked last month, such as falling input prices and excess inventories reported last week at big box retailers like Target, Kohls, and Walmart (which we had projected in the November 2021 article [Will Shortages Lead To Gluts?](#))
- Emergence of climbing global bond yields since 1980 have been consistently followed by some deflationary event that contained the rise:

1986 oil crash, 1989 fall of USSR, 1991 Japan going bust, 1998 Asian contagion, 2001 China joining the World Trade Organization, 2008 housing bust, 2011 Eurozone debt crisis, 2013 shale revolution, 2020 global pandemic. Perhaps another deflationary event may be just around the corner as risks of recession rise.

- Once stocks breached the 20% threshold, the time it took to reach their bottom before beginning a new bull market was often surprisingly short: 39 days in 1966; six days in 1987; 36 days in 1990; the same day in 1998; 12 days in 2011; the same day in 2018; and 11 days in 2020. The four exceptions to these brief periods were: the start of the 1970s when it took 117 days; the end of the inflation era in the early 1980s when it took 157 days; the early 2000s Tech Wreck where it took 595 days to bottom; and the 2008-09 Great Financial Crisis, which took 241 days.

How much lower until the bottom?

Nearly every stock bear market for the MSCI World Index came alongside a global economic recession. Non-U.S. stocks do not seem to have fully priced in a recession, but they may be close. The price-to-earnings (PE) ratio for international stocks, represented by the MSCI EAFE Index, has rarely been lower than it is today, outside of a recession.

So here is where we stand. A dual loss market in 2022. I want to encourage you to do several things. One is to be sure in turbulent markets like we are in right now, have a lot of cash and/or bonds. The article on I-Bonds was timely this year. I-Bonds have a 9.62% lock on rates for the current 6 months. The rate adjusts every six months based on the long-

term Treasury bill rate plus the inflation rate meaning November may surpass 10%.

<https://lifecanbesimple.net/blog/safe-place-to-invest-50-today>

I personally at my advanced age have 54% of my investments currently in Cash or bonds, with a large segment weekly going to I-Bonds. The next thing to be sure of is to have a lot of money in the overall stock market indexes. ETFs like: ITOT VTI SCHB VOO SPY etc.

And then be sure you have some investments across all the 11 sectors of the market. I discussed those 11 sectors in my article on investing with ETFs.

<https://lifecanbesimple.net/blog/simple-path-to-investing-with-etfs>

When you diversify, that helps you to offset bad sectors with those that are great. All of the time some sectors are outperforming others. This year the oil and gas business has been the best with Exxon up 61% this year. Health care is another sector performing well in the current market.

So if you are diversified, and have a lot of money in full market stock indexes, does that guarantee you no loss in a huge drop in the market? No, it does not. That is why I am so cash conscious right now. When you look at the news, with problems all over the world, Russia invading Ukraine, and the leaders in Washington out of step in almost every area, what is the likelihood that we will go from the current 33,500 NYSE average to 36,000?

It might happen, but with all the gloomy news, we may be ready for another huge drop like in 2008 or 1972 or worse of all, 1929. I wasn't around for the great depression, but I remember both 2008 and 1972, and both were hard to bear. I hate to be a bearer of bad news, but realistically, we could go from 33,500 to 25,000 very easily, and a drop to 15,000 would not greatly surprise me. That would mean a 50% or greater loss in your average stock holdings. Can you withstand a loss of 50%? I am too old to recover from such a huge loss. If you are in your 20's, you could. But would it not be smarter to have some insurance against such a catastrophic loss?

Recently I have read 4 of Richard Kiyosaki's books in the Rich Dad, Poor Dad series. Last week, I watched one of his online seminars, and in that presentation, he said he does all he can to NEVER lose money. Now to never lose money and invest is pretty much impossible, but there are ways to hedge your losses. Mr. Kiyosaki introduced me to several, and one of them I want to cover today.

This method is like having an insurance policy. How this is done is by issuing a STOP LOSS sell on your stocks and ETFs. Mutual funds and Nasdaq stocks are not eligible for this, but the ETFs and Stocks with 1 or more shares held are. If you have never heard of a stop loss sale, let me explain it a bit. A stop loss LIMIT order allows you to specify the price you will receive on the stock or ETF when you set the value to trigger the sale.

Now, remember that a down market generated this sale. Is it possible that if you specify a LIMIT, you will receive it? Possibly, but unlikely. So, your order might never process. Now if you do not specify a LIMIT on the stop loss order, then it probably will be filled, but not at the price that you specified to submit the sell order. You would receive the current market price if there is a buyer.

So if you specify the stop loss to be issued at \$40 for example, probably the best you could hope for would be \$39 or a bit over. And someone has to agree to buy it. For every sell order, someone has to buy. So if it is a huge market drop, your \$40 stop loss might wind up sold for \$35 or not at all. So keep in mind, that a STOP LOSS order is not a contract for the price you specified. Just a request to sell at the current market price.

What I did this past week was I went into my holdings at Fidelity, Schwab, and Vanguard, and any with a substantial balance on them, I clicked on the SELL tab. From there, I choose STOP or STOP LOSS (depends on the broker), and you key in the price you want to trigger the sale. As I mentioned earlier, I buy all my stocks and ETFs to hold long-term, so I do not want them to sell on a minor bounce in the market.

Richard Kiyosaki suggested using 80% of the current value which is what I used. So on a \$50 stock price, if it goes to \$40, it will trigger the sale. Now of course this does mean I would lose 20% of the value of the security, but a 20% loss is so much less than a potential 50 to 80% loss.

At Fidelity, I chose a GTC order meaning Good until closed or canceled. I did the same at Schwab and Vanguard, but their GTC orders are only good for 60 days. So on Oct. 12th, I will have to rekey those. Of my 80 or so holdings, I am only entering 15 to sell with Stop Loss orders. I may bump those up in time, but the big holdings are what concern me.

I found a great video on Fidelity explaining how to understand and place stop-loss orders. Watch it here:

<https://www.fidelity.com/learning-center/trading-investing/trading/stop-loss-video>

Should you consider a STOP LOSS order for your larger holdings? If you consider the danger of the current market, I do think it is worthy of consideration. In life, I have found that you normally don't need insurance if you have it. So, if you key in some stop loss orders and never use them, it is just insurance. BUT, if the market takes a huge downturn, and it could happen, you will eliminate some of your loss.

Think about it and read some other authors on the topic and discuss it with your broker. Since we no longer pay commissions to buy and sell Stocks or ETFs, we can simply repurchase the sold items if it was done in just a market shakedown. But if a catastrophic drop, I think you will be glad you did sell.

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