FINANCIAL POST

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Four lessons to help you be a good investor when it feels like the stock market world is coming to an end

By Ted Rechtshaffen

Stock markets these past few months have been supported by fear. Here are four lessons to help you stay the course even when you want to run and hide

In the past few months, most of us had a feeling that was eerily familiar: That sense that everything you invested in, whether it was a "safe" bank or a risky tech stock or a "widows and orphans" utility stock, all seemed headed for disaster.

Of course, stock markets are always bouncing off the walls of fear and greed and the past few months just happened to be supported by fear. If you listen to Warren Buffett, one of the most important investment goals is to try your best to be a buyer when fear is rampant. But, that is much easier said than done.

In addition to buying on fear, here are four more lessons that you can help you get through downturns without losing sleep or bailing out at the worst time.

1. What goes down quickly, often comes up quickly

Let's take a look at a few big stocks, with their price on Dec. 1, 2015, Jan. 15, 2016 and then March 4, 2016.

TWELVE VOLATILE WEEKS

	Dec. 1	Jan. 20	March 4
ROYAL BANK OF CANADA	*$76.88*	*$65.62*	*$71.38*
ENBRIDGE INC.	*$48.26*	*$41.23*	*$48.91*
CRESCENT POINT ENERGY	*$17.93*	*$12.21*	*$18.04*
BCE INC.	*$57.69*	*$53.55*	*$57.51*

SOURCE: TED RECHTSHAFFEN NATIONAL POST

In the seven weeks from Dec. 1 to Jan. 20, these four stocks were down 17.1 per cent not including dividends. That was a major drop.

In the following six weeks, to March 4, these four stocks actually went up 20.6 per cent. The net result over 12 weeks was a decline of 1.4 per cent, but, if you add dividends, then these four stocks were pretty much flat.

One of the thoughts on this 12 week journey to investment hell and back is that if you didn't pay attention for 12 weeks, you would have had no sleepless nights (unless you were watching the Republican primaries).

A related lesson is that, when everything seems like it is going down, unless you need cash at that moment, the best option is usually to give it time to bounce back. If the names of the investments are good ones, they usually do bounce back, and sometimes fairly quickly.

2. True diversification will help

A second lesson is that for those of us who don't want to get too worried about investments, diversification by type of investment and industry is very important.

If you purchased the Nasdaq index on March 10, 2000 and held it until Sept. 20, 2002, your investment would have dropped more than 77 per cent. This period and that particular index captured the worst of the dot-com bubble. During the same period of time, Wal-Mart stock was up 4.2 per cent (including dividends). While two separate investors could have been invested in "stocks" in the same period, one suffered a terrible collapse while the other was up.

If someone put half their money in both, it still would have been bad, but they would be down about 36 per cent, certainly better than down 77 per cent. Taking diversification a step further, the iShares Bond Universe ETF began on Nov. 20, 2000. If one bought it on that date and held it to Sept. 20, 2002, it would have been up 17.1 per cent. The Nasdaq index over the same period of time was down 59.6 per cent.

The key message here is that diversification is when you truly are investing in things that will act very differently over time. Buying two different precious metals mutual funds is not diversification. Buying 10 different stocks that all happen to be oil exploration companies in Alberta is not a good example of diversification either.

If you truly believe in one sector and are comfortable with sizable shifts in the value of your portfolio, then there is no need to diversify. However, for most investors, proper diversification will allow you to better manage the volatility, and help your portfolio maintain much of its value even on days like Jan. 20 2016.

3. Alternative investments can be your friend

During 2015, the TSX was down 8.3 per cent, including dividends. At the same time, the $77-billion OMERS Pension Plan was up 6.7 per cent. This was a great result. More interesting was the breakdown on returns: on publicly traded investments, the fund returned 0.7 per cent; on private investments, the fund returned 14.5 per cent! Private investments include private equity, infrastructure and real estate, and represented 48 per cent of the funds' assets at the end of 2015.

While most of us can't access the same types of private equity or infrastructure investments as OMERS, there are now some opportunities to invest in mortgages, private debt, real estate and factoring, which usually allow you to earn returns in the five per cent to 10 per cent range with investments that do not react closely to the overall stock market. The learning here is that it is probably time to find ways to build up this part of your investment portfolio, where possible, and it's most likely these investments will help smooth out overall returns.

4. A long-term plan can make a disaster feel like a bump

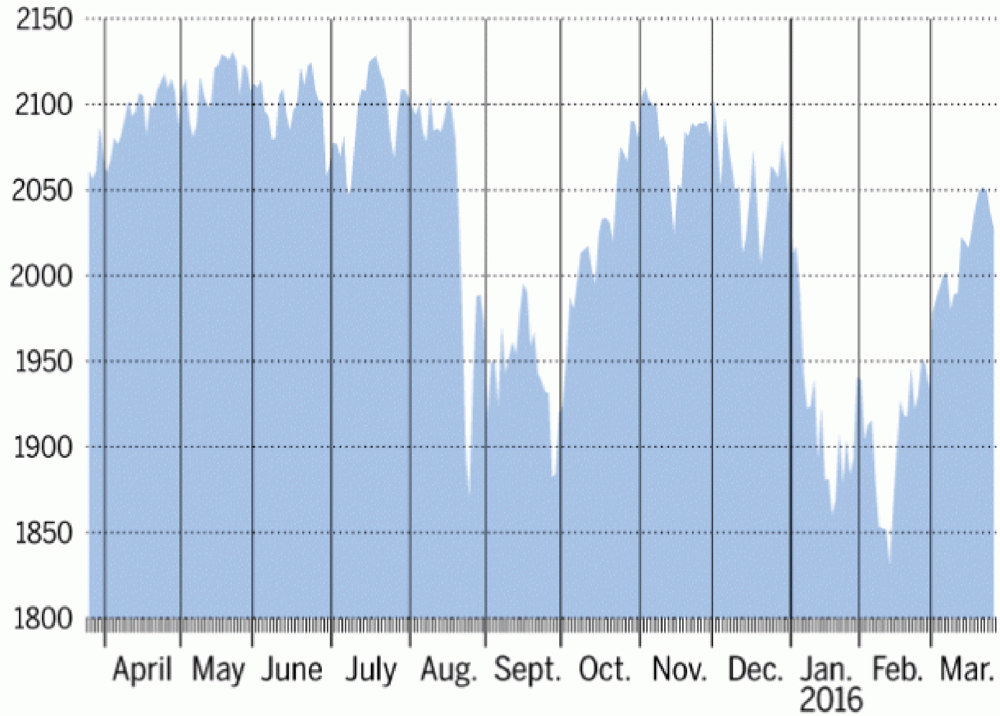
One of my clearest memories of the crash of 2008 was doing some financial plan reviews with nervous clients. We took their current financial picture, assumed NO growth for the following two or three years (even though we thought it would be above-average growth) and then continued with slightly lower-than-average growth expectations for the rest of their lives. At the end, if we could show that they would still have almost no risk of running out of money, it provided them with some peace of mind at a time when it seemed like markets were headed all the way to zero.

The plan gave clients a long-term perspective at a time when only short-term fear was in the air. It allowed them to feel comfortable maintaining the course, and to not shift into cash at a very bad time.

In the chart below, you can see the S&P 500 over the past year. There have been two meaningful declines, and overall it was down 4.7 per cent from March to March. It doesn't inspire investment confidence. However, if you look at the same S&P500 index from a 65 year perspective, it should give some comfort that things will be okay.

S&P 500

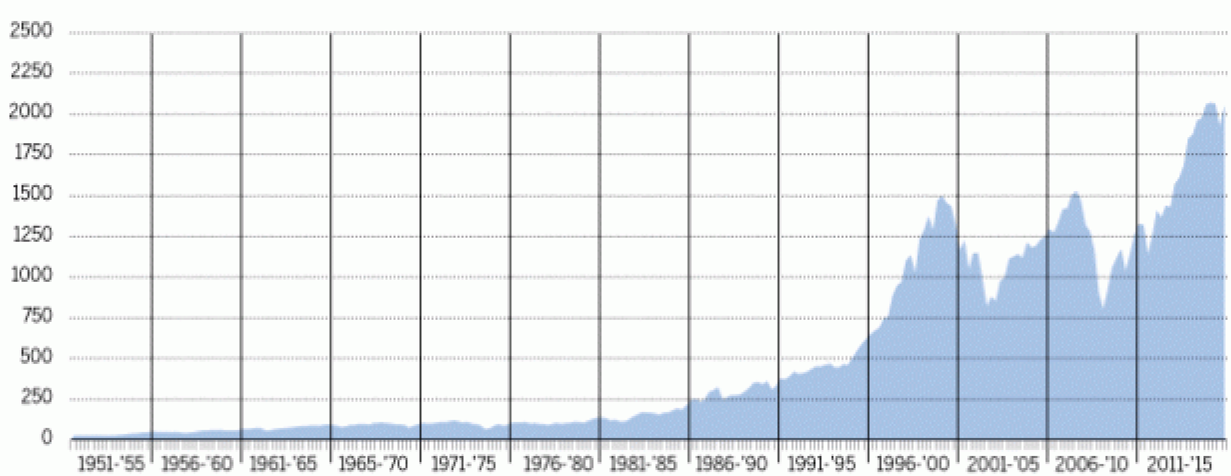
DAILY, MARCH 25, 2015 TO MARCH 24, 2016



SOURCE: BLOOMBERG NEWS NATIONAL POST

S&P 500 OVER 65 YEARS

QUARTERLY, SEPTEMBER 1951 TO DECEMBER 2015



SOURCE: BLOOMBERG NEWS NATIONAL POST

So, the key lesson here is that a long-term view of your personal situation will provide a truly important yardstick of how you will be affected by short-term markets. If that isn't enough, a long-term view of markets themselves should give you much more comfort than worrying about the daily headlines.

In summary, when it feels like the stock market world is coming to an end, the two keys would be to make sure that your investment portfolio is structured smartly to minimize some of the pain, and to have the long-term perspective to know that this too shall pass.

Illustration by Chloe Cushman/National Post

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