HBKS® Wealth Advisors

How to Survive a 'Bear' Attack

Sorry to disappoint any survivalists out there looking for advice on how to fend off a black bear in the middle of the woods, but this article is meant to help investors as they face the threat of an equally frightening bear — the bear market.

What is a Bear Market?

A bear market is typically defined as a 20 percent or greater decline in the equity markets. Investors have had to endure two separate and distinct bear markets in the first decade of the 21st century already. While it is impossible to predict precisely when a bear market may occur, one should note that they are inevitably out there lurking in the shadows, waiting to strike. With this in mind, here is some guidance on prudent behavior to employ within investor portfolios in an effort to minimize the damage a bear market can bring.

Know Your Risks as the Market Fluctuates

Probably the best starting point is the notion of the equity markets being inherently volatile. According to research from JP Morgan*, the S&P 500 ended the calendar year in positive territory for 26 years out of the last 34 years. However, the average intra-year decline in the market was a drop of approximately -14.4 percent.

This leads into my first suggestion on portfolio construction: Make sure the level of risk you maintain in your investment portfolio is suitable for bear and bull markets (that is, a full market cycle). For example, 2013 was somewhat of an anomaly in that the S&P 500 finished the year up 30 percent (on December 31, 2013) and only experienced an intra-year decline of -6 percent. Sadly, this is the exception and not the norm.

My point is that it is easy to favor equities when they are advancing and "making new highs;" however, the disciplined investor won't necessarily abandon all their equities when they decline in value either. Take the time to have a discussion with your advisor about potential downside risk within your own portfolio to see if any adjustments in portfolio positioning may be warranted.

Rebalance Your Portfolio As Needed

The second suggestion pertains to the concept of rebalancing your investment portfolio as needed (that is, selling and/or trimming asset classes that have appreciated markedly in value and adding to areas within your portfolio that are underweighted). This is challenging for some investors, as they tend to hang on to investments too long under the assumption that the good times can keep on rolling. Conversely, individuals are reluctant to add to positions when their prices have declined in value. This is an area where a good financial advisor can add value, as we tend to operate without emotional bias toward specific investments. Rebalancing is typically done along the lines of an agreed to investment policy statement with a corresponding model/target portfolio as the benchmark. *(continued on page 2)*

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Consider the Three Pillar Concept

The third area to focus on is to construct a portfolio around the "three pillar" concept. This theory purports that investors could improve their diversification quotient by incorporating the third (and, unfortunately, often overlooked) pillar of alternative investments along with the more traditional "two pillars" of global equities and global fixed income. Inclusion of alternative investments has the potential to improve the risk/return profile of an investment portfolio, as they are inclined to exhibit a negative correlation to stocks and bonds.

Diversification does not work all the time and neither can it protect against a loss; however, history shows that it does work over time for the patient investor. Every investor is different and unique when it comes to portfolio construction. Knowing your time horizon, risk tolerance, and setting goals for your portfolio is a great starting point to realize financial success. Revisiting these themes over time also will go a long way in procuring the vitality of your investment portfolio. □

* *JP Morgan Asset Management,* Guide to the Markets*, 1Q 2014, p. 16*

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