Do’s and Don’ts in a Recession

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Whispers of a recession are growing louder in 2023. Against a backdrop of high inflation and a wildly volatile market, investors may start to feel a little bit queasy as economic headwinds grow stronger.

But it is important to realise that recessions don’t last forever and by turning fear into positive action, investors can ride out the turbulence. Here are the smart money moves investors can make to fortify their position and perhaps even thrive during a downturn.

1 Don’t Panic Sell

Whether this coming recession will be a deep or shallow one, it is important to not overreact and make rash decisions in your portfolio like panic selling. Not only would you be crystallising your losses, but you would also lose out on the opportunity to make future gains when markets rebound.

While bear markets can feel like forever, the truth is that it doesn’t last for long. The shortest bear market we experienced was of course in 2020 at the onset of the COVID pandemic, where the MSCI World Index plunged by over 33%. But the recovery was equally swift and rapid, where global equities recouped back all its gains in over a month and have climbed to new highs since.

2 Don’t Try to Time the Market

If investing guru Warren Buffet can’t get the timing right all the time, what are the odds for the rest of us? While it is tempting to make predictions of when markets will reach its bottom, the truth is nobody knows for sure.

The wiser strategy is to adopt a dollar-cost averaging (DCA) approach by investing in fixed sums in regular intervals regardless of market conditions. This helps to lower the purchase price of your investments over time by taking advantage of market dips as well as reduces the risk of bad timing.

3 Don’t Stop Investing

In a recession, it is easy to get lost in a sea of red and negative headlines that can petrify investors. But as often put, ‘smooth sails never made for a skilled sailor’. Historical data has shown that investors who held on to their portfolios and continuously invested fared much better than those who cashed out during the scary dips, when markets eventually recovered.

Always keep a long-term perspective and ensure that you only invest money that you will not need for several years. If you unexpectedly fall into hard times, that is where an emergency fund comes in to help tide you over until you get back on your feet. As a rule, you should strive to save at least 6 months’ worth of living expenses in an emergency fund.

4 Do Practice Diversification

Another critical tip to recession-proof your portfolio is to practice diversification. A well-diversified portfolio composed of different sectors and regions would allow investors to hedge their bets especially when economic conditions become constricted. Certain sectors and businesses may be impacted more than others during a recession as demand wanes and borrowing costs rise.

Investors should also consider allocating a portion of their portfolio to bonds which tends to hold up better than equities in a slower growth environment. While there has been some volatility in the fixed income space recently, it is still an invaluable component to any portfolio by providing capital preservation and a stable income stream.

5 Do Recheck your Risk Profile

A recession can drastically impact your personal and financial circumstances which can alter your capacity to take risks. For instance, getting a pay cut or being laid off means that your tolerance for volatility may no longer be as high as it was. In that case, you might want to load up on more defensive assets or funds to buttress your portfolio such as bonds and dividend-focused strategies. It may be useful to also set aside a bit of cash in your portfolio that can help insulate against losses as well as serve as dry powder for tactical opportunities. Importantly, investors should always be comfortable with the level of risk they are taking and be able to live with the market pullbacks that will surely occur.

6 Do Nothing

Once you have set up your portfolio that is tailored towards your risk profile and needs, the most crucial (and also hardest) step for investors is to simply just do nothing. Markets will inevitably ebb and flow, but it is important to keep a cool head and avoid giving in to our worst impulses when things get volatile.

While it may be important to regularly rebalance your portfolio to reset your asset allocation targets, it is best to avoid doing too much or making too many tweaks in a downturn. Stick to the plan and acknowledge what is and is not within your control. Some things are worth letting go especially in the muddled world of finance. Because ultimately, investing is a game that favours the patient and bold.