

Lessons Learned from the Great Recession

Keeping your cool can be difficult when the market goes on one of its roller-coaster rides. It's useful to have strategies in place that prepare you both financially and psychologically to handle market volatility. Here are six strategies that will help to achieve your financial goals.



Professional Opinion

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1. Have a game plan.

Having guidelines that recognize the potential for turbulent times can help prevent emotion from dictating your decisions. You might take a core-and-satellite approach, combining the use of buy-and-hold principles for the bulk of your portfolio, with tactical investing based on a shorter-term market outlook. Diversifying will help offset the risks of certain holdings with those of others. Diversification may not ensure a profit or guarantee against a loss, but it can help you understand and balance your risk in advance.

2. Know what you own and why.

When the market goes off the tracks, knowing the reasons why you originally made a specific investment can help you evaluate whether your reasons still hold, regardless of what the overall market is doing. Understanding how a specific holding fits into your portfolio also can help you consider whether a lower price might actually represent a buying opportunity.

If you don't understand why a security is in your portfolio, find out. That knowledge can be particularly important if you're considering replacing that holding with another investment.

3. Remember: Everything's relative.

Most of the variance in the returns of portfolios can generally be attributed to their asset allocations. If you've got a well-diversified portfolio that includes multiple asset classes, it could be useful to compare its overall performance to relevant benchmarks. If you find that your investments are performing in line with those benchmarks, you might feel better about your overall strategy.

A diversified portfolio is no guarantee that you won't suffer losses. But diversification means that just because the S&P 500 might have dropped 10

percent or 20 percent doesn't necessarily mean your overall portfolio is down by the same amount.

4. Manage your mindset with cash.

Cash can be the financial equivalent of taking deep breaths to relax. Having a cash cushion coupled with a disciplined investing strategy can change your perspective on market volatility. It can enhance your ability to make thoughtful decisions instead of impulsive ones. If you've established an appropriate asset allocation, you should have resources on hand to prevent having to sell stocks to meet ordinary expenses or, if you've used leverage, a margin call. Knowing that you're positioned to take advantage of a downturn by picking up bargains may increase your ability to be patient.

5. Consider playing defense.

During volatility, many investors reexamine their allocation to such defensive sectors as consumer staples or utilities — though like all stocks, those sectors involve their own risks and are not immune from overall market movements. Dividends can also cushion the impact of price swings. According to Standard and Poor's, dividend income has represented roughly one-third of the monthly total return on the S&P 500 since 1926, ranging from a high of 53 percent during the 1940s to a low of 14 percent in the 1990s, when investors focused on growth.

6. Remember your road map.

Solid asset allocation is the basis of sound investing. A diversified portfolio is important so that strong performance of some investments can offset poor performance by others. Even with an appropriate asset allocation, some parts of a portfolio may struggle at any given time. Timing the market can be challenging under the best of circumstances; wildly volatile markets can magnify the impact of making a wrong decision just as the market is about to move. Make sure your asset allocation is appropriate before making drastic changes.

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