Four Strategies for Investing in a Recession

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When the economy is buoyant, generally so are the financial markets. Of course, they fluctuate on a day-to-day basis, but their overall trend has been to move higher since robust economic activity means greater sales and improved profits for corporations. In a strong economy, investors can generally expect to see their investment portfolios gain over time.

But when the economy is heading towards or in a recession, making money from your investments, or even just preserving the value of a portfolio, becomes somewhat more challenging.

What is a recession? Economists generally define it as at least two quarters of negative gross domestic product (GDP) growth. That means there is a significant decline in economic activity: profits and employment fall, the stock markets decline, consumer and business confidence weaken.

When that happens and we see the value of our portfolio fall, many of us may just want to sell all our investments and move to the safety of a money market fund or savings account. That’s a normal response. In their seminal study, behavioral economists Daniel Kahneman and Amos Tversky found that it is human nature for us to try to avoid losses. They called that “loss aversion,” one of the strongest behavioral biases identified.

Many investors may also find themselves prone to another behavioral bias: recency bias. We may remember the stock market crash in 2008, or the end of the technology boom in 2002, and how difficult everything seemed. Some investment portfolios may have lost more than 30% of their value in those downturns, job losses were rampant, and the outlook was bleak.

However, looking at stock market history, it’s obvious that the darkest time may have been among the best times to invest. Anyone who got into the markets in March 2009, when equities had declined by 57% from their previous peak in October 2007, would have enjoyed relatively steady gains for the following decade.

Listening to our head and not our gut is usually the best prescription for successful investing.

As famous investor Warren Buffett once said, “A market downturn doesn’t bother us. It is an opportunity to increase our ownership of great companies with great management at good prices.”

Indeed, the first tenet of successful investing is to buy low, sell high. That means a recession and the market weakness that generally accompanies it can provide opportunity for the savvy investor.

Here are four strategies you can use to navigate your portfolio through a recession:

1. **Don’t sell everything at the first sign of a market downturn.** Selling your investments when they have fallen just means you will lock in your losses. But if you can’t sleep due to the market’s wild gyrations, then reducing your exposure to the riskier assets—like stocks—may help you feel better. While most investors need equities in their portfolios to provide growth, fixed income assets can usually provide stability and a steady stream of income. Bonds typically move in a different direction than equities. That’s why it’s so important to have a diversified portfolio.

2. **Reassess your portfolio.** Markets are likely to remain quite volatile until the economy begins to show signs of life, so you may want to think about your risk appetite. Is your asset mix still the right one for you? This will depend on your particular circumstances: your goals, time horizon, your ability to absorb further losses. Additionally, if your equity holdings have fallen substantially, you may need to rebalance to ensure your portfolio has the potential to provide the growth you need in the future.

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3 Dollar Cost Averaging is designed to reduce the impact of market volatility by investing a set amount at predetermined intervals regardless of fluctuating price levels.

For example, consumer staples are businesses that do relatively well no matter the economy. Perhaps you won’t buy a new smart television when times are tough, but you will probably continue to buy shampoo, toilet paper, and cleaning solutions. While you may not buy a new phone, you are likely to keep your phone plan.

The same goes for utilities. It would have to be bleak indeed not to keep the lights on and water flowing from your taps. And dividend stocks have historically been good sources of income during good times and bad. However, in significant downturns a company may make the difficult decision to cut their dividend. While rare, it does happen.

4 Implement strategies that may help keep your emotional responses in check. Since volatility is likely to continue until the economy stabilizes, dollar-cost averaging can be a powerful tool to keep you investing. Opting for a dynamically-managed multi-asset strategy can help you diversify and potentially smooth out returns. So can adopting a more global mindset, as different geographical regions and industries may recover from the downturn sooner than others.

Don’t forget that recessions are a normal part of the business cycle. We have gone through six of them since 1980, each caused by a different set of circumstances and events. In 1980, the Federal Reserve raised interest rates to curtail inflation. Recessions in 1981 and 1990 were caused by the new Iranian regime decreasing its oil output, and Iraq invading Kuwait, respectively. The 2001 recession was the result of the dot-com bubble bursting as well as the September 11, 2001 terrorist attacks, and Enron and Swissair accounting scandals. The subprime mortgage crisis sparked an 18-month recession beginning in 2008, and the Coronavirus pandemic set off a recession in early 2020.

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