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Stocks And Your Queasy Stomach

By Karin Price Mueller | NJMoneyHelp.Com
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Q. I know the post-election season will be volatile. I don't like the bumps but I have 20 years before I retire so I know I need to take some risk. How do I pick the best portfolio that won't make me nauseous? – Nervous

A. Investing does not have to include an amusement park ride that leaves you feeling queasy. It's of paramount importance to understand how you feel about risk and invest accordingly.

By staying invested, choosing low-cost securities, diversifying broadly, and remaining opportunistic with your portfolio over the next 20 years, you'll greatly increase the probability of achieving your long-term goals, said George Kiraly, a certified financial planner with LodeStar Advisory Group in Short Hills.

He said even with some horrible stretches, the Standard & Poor's 500 Index has produced an average 20-year return of 7.25 percent dating back to 1926.

Now, volatility is a completely normal part of the investing landscape. It has been around forever — even before this last election. Kiraly said to stay invested over a long time horizon, you need almost a willingness to embrace and endure volatility, which has tended to reward investors. In fact, he said, the greatest rewards often immediately follow the darkest periods of market turmoil.

"If possible, look to take advantage of opportunities that occur due to volatility and the investment mispricing it often produces," he said. "For example, when oil prices declined precipitously earlier this year, the markets took down the entire sector. Oil prices were never going to zero, despite what the media was saying at the time." Kiraly said he bought an energy-related exchange-traded fund (ETF) when oil plunged to $26 per barrel. Oil prices have since rebounded smartly, which has produced a +35 percent gain for the ETF.

Kiraly said the problem is that most investors simply cannot handle volatility on an emotional level.

He said you indicate your time horizon is 20 years, but it's probably 20 years longer or even more when you consider your retirement years. The question is: "Will you be able to remain invested for the duration?"

"If the answer is `yes,' then implementing a strategy focused on minimizing investment expenses and diversifying broadly will go a long way toward ensuring your portfolio isn't torpedoed by high costs, a few bad stock picks or the occasional deep correction," he said. "Passive, low-cost securities, including index funds and ETFs, would be a great choice for the majority of your portfolio." Just remember to diversify your investments into different equity sectors and regions, and across asset classes, Kiraly said.

You will still have to deal with the occasional big bear market. Adding bonds, an alternative investment or two, and cash can help reduce the risk of your portfolio, he said. If you want a serious cushion for volatility in your portfolio, you need to add these asset classes.

If you still think you may panic and abandon your strategy at some point, there are a few additional strategies you may wish to consider.

Historically, less risky stocks (as defined by volatility or market sensitivity, or beta) have offered better risk-adjusted returns than their riskier counterparts, Kiraly said. "Low beta investments act as a buffer during periods of higher stock market volatility and can help you control risk," he said. "`Low-Volatility' and `Minimum-Volatility' funds have the potential to limit losses during bearish market conditions while participating on the upside in bullish market trends."

That's because they hold larger, more stable stocks with significant revenue and earnings that help support stock prices in times of market turbulence, Kiraly said. "Low-volatility funds performed remarkably well over the last several years, however, the problem right now is – they look too expensive to own," Kiraly said. "Investor demand has driven up valuation levels and as a result, performance has been suffering over the last few months."

Another volatility-reduction strategy would be to buy a basket of stocks, via a low-cost ETF, that have consistently grown their dividends over very long periods of time, Kiraly said. These companies tend to be high quality, with strong fundamentals, stable earnings and solid management. Historically, consistent dividend growers have delivered solid performance with lower volatility, even after being subjected to repeated market turmoil, he said.

Whatever your investment mix, make sure to rebalance your portfolio once a year to make sure your target allocation remains intact, which will help avoid adverse changes to your risk profile, Kiraly said.

"Stock market fluctuations can be hard to stomach sometimes. The timeless lessons – staying invested, managing costs, not trying to time the market, and diversifying broadly – remain the best blueprint for success," Kiraly said. "If you still think you may have trouble staying on track with your investments, working with a fee-only financial advisor may help when dealing with the very important emotional side of investing."

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