

# WHAT'S YOUR STRATEGY

## for the Next Downturn in the Market?

financial  
fitness



By **Rocky Mills**, North Ranch Resident

With the stock market at record highs, it's a great time to review the strategy you have in place to deal with the next market downturn, whenever it comes.

Let's start here: Hope is not a strategy. **Hoping** the losses won't be too big, or **hoping** the market will come back up does not qualify as a sound financial approach.

**You need a plan. You need to put something in place today with a goal of cushioning your nest egg from what otherwise could be a devastating blow from a significant**

**market drop.** The plan does not need to be elaborate, nor do you have to pay someone to do it. But if you are paying someone to manage your investments, make sure they have a plan!

Here are some of the elements that go into a sound strategy:

### NON-EMOTIONAL

Behavioral Finance examines how human behaviors affect financial decision-making. It's not good. The volumes of studies done since the late '70s conclude that emotions lead to reduced performance. It causes buying near a market top ("I have to get in - I don't want to miss this") and selling near a bottom ("I can't take this"). And once they're out of the market, they stay out and miss the next leg up ("That didn't work so well last time—I won't do **that** again").

### OBJECTIVE

To be non-emotional, you need to use measurable facts instead of subjective interpretations.

Examples of **measurable facts**: The price of a stock or an index, the dividend payout ratio, the interest rate on the 10-year U.S. Treasury note.

Examples of **subjective interpretations**: A news flash on TV, what you heard at a cocktail party, your feelings (pro or con) about the President or Congress.

### RULES-BASED ACTIONS

Once you have chosen the set of measurable facts you want to use, you need to set up rules for action. For each measurable fact, you will establish

**The threshold.** Once your measure violates a threshold, you take action. For example, if you were measuring the price of XYZ stock, and if XYZ was currently trading at \$40, you might set a threshold of \$35.

**The qualifiers.** Simply crossing a threshold may not be enough to trigger an action; you may want to add some qualifiers. In the example above, you may want to add that the price must stay below \$35 for three consecutive daily closes.



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**The action.** Here's where you define the action you will take once a fact violates a threshold and meets other qualifying criteria. To complete the example above: If the price of XYZ stays below \$35 for 3 consecutive daily closes, sell the entire position.

These rules establish, **in advance**, the actions you will take. Non-emotionally. Objectively. Don't go into the next market downturn – whenever it comes – without a formalized strategy in place.

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