How to Protect Your Portfolio in Falling Markets

ISACO

LET'S BUILD WEALTH TOGETHER.

Your aim as an ISA and SIPP investor should be to profit in rising markets and protect in falling markets. This is not easy to do but made easier when you understand how market cycles operate.

ISACO's premium clients have the privilege of receiving investment guidance directly from an investor who has historically 'beaten' the stock market.

Investors with a history of beating the market are rare and I'm sure you'll agree that outperforming the stock market is extremely difficult to achieve. However beating the market does help you to achieve above average performance allowing you to arrive at your financial goals faster.

ISACO's lead investor is a trend follower and market timer and his aim is to get in sync with the markets trend and direction. Rather than swimming against a current, he prefers to swim with it. A full economic cycle lasts about 5 years and consists of a bull market and bear market. A bull market is when the market forms an uptrend and a bear market is when the market forms a downtrend.

Bull markets can be seen as the 'boom' part of the cycle and the bear market can be seen as the 'bust' part. Your aim should be to ride the wave of the bull market and stay fully invested. This is typically a two to four year period. During this time, you don't move into cash. Instead you stay fully invested in high quality investment funds and sit patiently in your investment funds until the bull market has run its course.

When the bull market ends, a bear market begins. This is when your investment strategy changes from 'profit' to 'protect.' 75% of investment funds move in the same direction as the stock market and if the market is falling (bear market), most investment funds will drop irrelevant of their grade or manager status.

This means investing against the markets trend is dangerous. Investing in investment funds during bear markets is high risk. In bear markets, the best place to be is cash.

Here's how it works: When a bear market takes hold, you move into cash. This gives full protection to your ISA portfolio. To guarantee that your full ISA account will be safe, use a cash park.

The one ISACO prefer is Fidelity's ISA Cash Park. Switching from being invested in a quality investment fund into a cash park is just like moving your cash from the stock market to a bank.

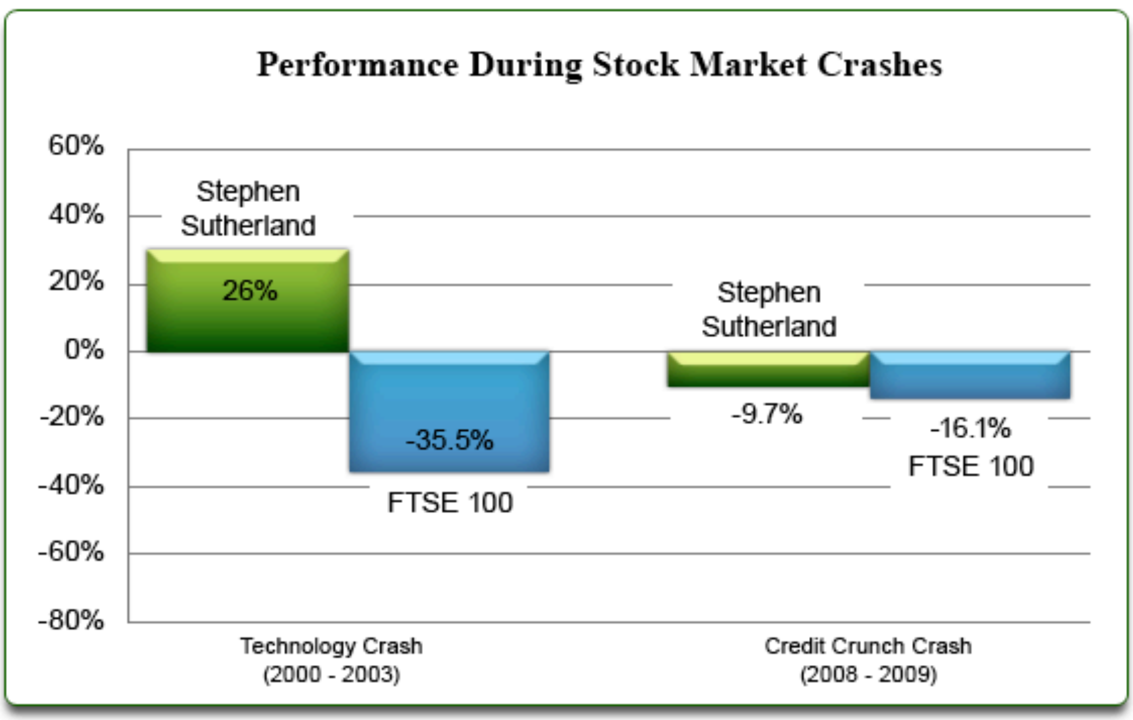
Bear markets are shorter in length than bull markets and tend to last 9-18 months. During this time you have to be patient and sit in cash until the bear market ends and a new bull market begins.

When the bear market is over, a new bull market begins and this is when you move back into quality investment funds. Take a look at this table and it will show you how it works.

Market description	Type of market	Estimated length of time	Aim	Frequent trading?
Bull market.	Rising.	2-4 years.	Profit – Invest in high quality investment funds.	No, only one or two trades to make per year.
Bear market.	Falling.	9-18 months.	Protect – Use cash parks to preserve profits.	No, only one or two trades to make per year.

By moving temporarily into a cash park when the market is falling, it helps to preserve and protect your profits made in the bull market periods.

You are probably aware that we've just recently been through one of the worst markets in history. Some of the main world stock market indexes lost over half their value. As you can see from this next image, in the two most recent bear markets, we've fortunately managed to outperform them both.



This table is to show you that it is possible for you to beat the stock market when it's falling.

These two market periods were arguably two of the worst bear markets in the stock markets entire history. In the 2000-2002 technology crash, our lead investor Stephen Sutherland was extremely fortunate to make a gain of 26% compared to the FTSE 100's 35.5% loss.

In the credit crunch crash of 2008-2009, he made a loss of 9.7% compared to the FTSE100's drop of 16.1%. These results tell you our lead investor helped ISACO's premium clients to beat the FTSE 100 in the two previous bear markets which is something 80-90% of DIY investors and advisers failed to do.

At this point it's worth mentioning that if you are an investor seeking long-term capital growth, and you fail to beat the stock market over the long term, it is probably going to have a damaging effect on your retirement plans. When you fail to hit the annual growth targets required, instead of you arriving at your goal on time, you arrive late.

This table highlights the dangers and shows what happens to your retirement plans if you underperform. In this example, we've used a person with a £250,000 portfolio whose aim is to grow it into a million pounds over the next ten years.

Starting amount	Retirement goal	Annual growth rate	Time frame taken to hit retirement goal	Arrived at goal on time?
£250,000	£1 million	15%	10 years	Yes
£250,000	£1 million	7.5%	20 years	No, 10 years late.
£250,000	£1 million	3.75%	40 years	No, 30 years late.

To be able to do that successfully, the person would have to grow their account at 15% per year which ISACO agree is no easy feat. However, it is possible when you have an edge.

The compounding rule is, when you get 15% annual growth, your money doubles every five years. That means at 15% annual growth £250,000 turns into £500,000 in the first five years, and then the £500,000 turns into a £1million in the final five years.

However, if you fail to get adequate growth on your capital, it is going to take you much longer to reach your retirement goals.

For example, if your adviser is one of the 80-90% of advisers that underperform the market, and helps you to achieve just 7.5% annual growth, it would take you twice as long to get to your goal.

Instead of getting to your objective in ten years, it would take you twenty. And if your adviser was in the bottom 20% of their field, and only managed to help you achieve 3.75% annual growth, it would take you forty years to get to your goal. That's thirty years late!

For some people, the risk of their adviser underperforming is too high. When a person realises the danger of underperformance, and how it will have an adverse effect on their financial future, their next step is to seek out help and guidance from a person or company with a history of beating the stock market.

If an individuals' adviser of one of the 80-90% who underperform the market, by staying with him or her, the person could be putting their family's future welfare in danger. Bearing this in mind, I hope you can see why attaining market beating performance should always be your ultimate objective.

Please remember, past performance is not a guide to future returns and the value of investments can go down as well as up and you may not get back the amount you originally invest. Eligibility to invest in an ISA will depend on your individual circumstances and all tax rules may change. If you are unsure of the suitability of an investment, please speak to an adviser.

Thank you for your time.

Yours sincerely,

Paul Sutherland
Managing Director

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