MarketWatch
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How to Rest Easy in a Crazy Market

By Michael A. Pollock , The Wall Street Journal

October's surge helped many mutual funds bounce back from recent lows.

It was also a vivid reminder of what has become a fact of life for stock investors: It's crazy out there. And it seems to be getting crazier all the time.

If the market's roller-coaster ride has caused you a lot of heartburn, this might be a great time to do something about it, before another slide is just one too many. After all, there are ways to turn down the anxiety without stashing all of your money in the mattress.

With that in mind, here are seven pointers to calm your portfolio and your stomach:

Get real about your tolerance for pain.

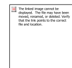
When stocks are mostly going up, many investors believe they have the fortitude to tolerate a fair amount of risk. But as soon as prices sink, so does their gumption. They realize they really aren't willing to ride the roller coaster down as well as up.

If you didn't learn your lesson before, learn it now: When your current stock exposure makes you queasy, take advantage of rallies to trim it back to a level—perhaps to around a third of your overall holdings—where you won't be tempted to bail out the next time the Dow Jones Industrial Average plummets 400 points.

But remember that you'll need to own some stocks in order to increase your assets enough for the future. Otherwise, once you retire, you'll have to be ultra cautious about how much of your savings you can spend without running short of money, says **Mark Cortazzo** , senior partner of advisory firm Macro Consulting Group in Parsippany, N.J.

Favor funds that cast a wider net.

The narrower the scope of your funds, the greater the risk of outsize losses during market downturns. Consider switching from some of your most narrowly focused funds to funds that hold a wider mix of stocks, or funds that combine stocks with other holdings, such as bonds.



This year, funds that focus only on financial companies are down 14%, according to Morningstar Inc., which tracks and analyzes fund performance. Those funds that invest in a broad mix of large corporations—so-called large-blend funds—are down only about 1% in the same span.

And "conservative allocation" funds that mix a hefty helping of bonds with stocks are up 2% on average this year. Among these is James Balanced: Golden Rainbow (MFD:GLRBX) , which usually keeps 40% to 60% of assets in stocks and dials down equities when they seem less attractive.

The James fund so far this year has returned 4.5%, versus a 1.3% return for the Standard & Poor's 500-stock index (including dividends). The fund's 7.4% annual average return over 10 years ranks it in the top 3% of Morningstar's conservative-allocation category.

Hire a pilot who charts a smoother ride.

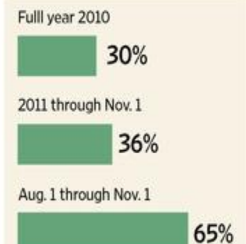
In stock-picking or other strategies, some fund managers try to limit the downside risk. When they succeed, their funds can be easier to keep for the long term. Funds managed with an eye to reducing volatility won't deliver top-of-the-charts performance when the market is surging. But they can hold their own over time, because it's easier for a fund to recover from a modest drop than a steep one.

This Year's Volatile Market...And Strategies for Coping

Value of $100,000 invested in the Standard & Poor's 500-stock index at midyear

Source: WSJ Market Data Group

Percentage of days when the S&P 500 moved by more than 1%



Note: Measured from one day's close to the next
Source: WSJ Market Data Group

Easy-to-Hold Funds

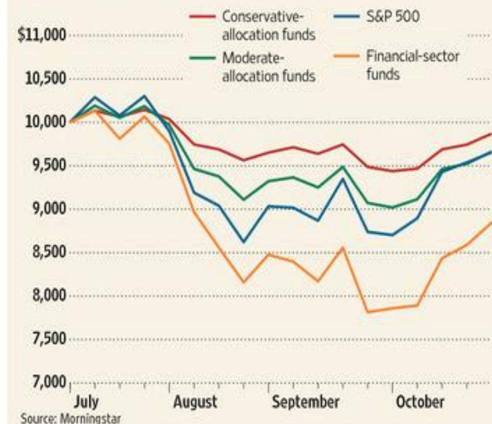
As of Oct. 31, these large-stock funds ranked in the top 20% of stock funds for their performance in down months over the past five years—and also ranked in the top 20% of their Morningstar categories for total return over five and 10 years.

Fund Name (Ticker)	Category	Bear-market % rank	Assets (mils.)	Five-year total return (annualized)
Amana Growth (AMAGX)	Large growth	17	$2,140	3.8%
Amana Income (AMANX)	Large blend	12	1,291	4.5
American Century Equity Inc. (TWEIX)	Large value	14	9,085	1.5
BBH Core Select (BBTEX)	Large blend	16	992	5.7
First Eagle U.S. Value (FEVAX)	Large blend	10	1,903	4.8
Invesco Charter (CHTRX)	Large blend	20	5,106	2.7
Sequoia (SEQUX)	Large blend	16	4,499	3.5
Vanguard Dividend Growth (VDIGX)	Large blend	17	6,615	3.6
Yacktman (YACKX)	Large value	20	5,909	8.3
Yacktman Focused (YAFFX)	Large value	18	3,809	9.3
S&P 500 index fund (Vanguard)		40		0.2

Notes: Bear-market percentile scores range from 1 (best) to 100 (worst). Funds with less than $500 million in assets excluded. Source: Morningstar

Diversifying for a Smoother Ride

Value of $10,000 invested at midyear. Financial-sector funds fell far more than the Standard & Poor's 500-stock index, moderate-allocation funds and conservative-allocation funds



Source: Morningstar

Aiming for steady moderate gains—even 6% a year—reduces the risk that you might need to dip into your portfolio at a point when it has lost a lot of value and thus hamper its recovery prospects, says **Michael Lynch** , an adviser in Roseville, Calif.

USAA Global Opportunities (MFD:UGOFX) , which holds U.S. and foreign stocks and bonds, uses derivatives such as options on market indexes to limit downside. But that also caps upside. The fund has a return so far this year of negative 2.4%, but that's almost seven percentage points less severe than the drop in a benchmark of global stocks, the MSCI EAFE Index.

Another volatility-reducing tack is owning a fund that focuses on blue-chip, dividend-paying companies. Shares of such companies are viewed as safer bets during tough economic times, and they tend to fluctuate less than those of growth-oriented stocks.

Vanguard Dividend Appreciation (NAR:VIG) , an exchange-traded fund, owns big players such as McDonald's (NYSE:MCD) Corp., Chevron (NYSE:CVX) Corp. and PepsiCo (NYSE:PEP) Inc. and yields about 2.3%. The fund has ultralow expenses of only 0.18% of assets a year. The lower the fees, the more investors get to keep in returns.

Don't try to wager on where stocks are headed.

Investors have a bad record of calling market tops and market bottoms. But over many years, stock prices will appreciate as the economy grows.

If you're holding a lot of cash, you are giving up an opportunity to benefit from that long-term appreciation, says **Constance Stone** , a certified financial planner in Chagrin Falls, Ohio. But if jumping back into the market all at once might fray your nerves, do it gradually, she says.

A way to reduce timing error is to simply rebalance holdings periodically. There is no consensus on how often to rebalance, but some advisers recommend rebalancing whenever the percentage of stocks in your portfolio has risen or fallen by more than about 10 percentage points from your preferred allocation. When stocks drop, shift some of your fixed-income assets into an equities fund. Shift it back after stocks have posted gains.

Fine-tune your cash stash to your family's needs.

You'll rest more easily if you know you don't need to tap your stocks and stock funds when they are down in order to meet expenses. That's one reason advisers often suggest clients keep on hand cash or readily saleable assets equal to three to nine months of spending. But for greatest peace of mind, your reserve should be tailored to your circumstances.

A dual-income family saving more than around 10% of income a month may need less than six months of cash, while a one-income family should have more, says **Marc Vorchheimer** , an adviser in Spring Valley, N.Y. If you have a mortgage, he says, keep cash on hand equal to about 20% of your outstanding mortgage principal balance plus whatever you need in the cash kitty.

Don't assume that a stock-free portfolio is risk-free.

As stocks plummeted this summer, investors shifted a mountain of money from stocks into bank accounts and government bonds.

But returns on those two investments are very low. And you could actually lose money on bonds if interest rates—which move the opposite way as bond prices—were to shoot higher.

Joseph Alfonso , a planner whose practice spans Northern California and Oregon, advises sticking to short bond maturities to lessen that risk.

If you want more risk, have it in the stock section of your portfolio, not the bond bucket, Mr. Alfonso says.

Don't be ashamed to seek help.

A financial adviser or planner can help you realistically assess your risk tolerance and tailor your investment strategy to it. Some larger advisory firms require clients to have hundreds of thousands of dollars in assets. But many planners don't set minimums and charge flat fees of as little as $1,000 a year.

Advisers not only aid in creating a strategy, but will help you avoid shooting yourself in the foot by abandoning it at the worst time.

"We'll try to persuade you not to sell when markets are down," says **Lewis Altfest** , principal adviser at New York-based Altfest Personal Wealth Management.

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