

## Recession-Proof Your Portfolio

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Okay—the news media tells us that we're either in a recession or just about to go into one. If a physician believes this, should it influence his/her portfolio choices?



“Of course, if you want to preserve and grow your portfolio optimally,” is what most financial educators would say. What’s surprising is that the solution isn’t even hard. Instead of the antiquated “Go West young man,” it’s the updated, “Go basic young person.”

What could be more basic than cash? When the market drops, dollars in hand can pay the bills without having to sell assets at a discounted price. The cash can be either from a steady salary for those who work or in a reserve as part of an overall portfolio for retired individuals.

Although dollars can earn interest in a money market fund, short term high quality bonds are another way to go because traditionally they pay more interest than a money market. For example, the Vanguard Federal Money Market (VMFXX) had a yield of 3.19% as of 12/31/07 while the Vanguard Short-Term Investment-Grade Investor Shares (VFSTX) has a yield of 4.22% based on the last 30 days. The current yield may vary on either. For those in a higher tax category, the Vanguard Limited-Term Tax-Exempt Investor Shares (VMLTX) had a yield of 2.99% based on the last 30 days, though the current yield may vary here too.

Buying something everyone needs, rather than just wants, is a good idea too. This is because discretionary spending does fall off in hard times. But, everybody needs the basics. The chart above illustrates this powerfully. Since October 2007, Consumer Discretionary SPDR (XLY) dropped 12% and Consumer Staples SPDR (XLP) remained relatively level. The expense ratio of both XLY and XLP is 0.23%. Each has a low turnover of 6%.

Vanguard Consumer Staples ETF\* (VDC) is another play in this area. It consists of every size stock and includes, according to its own description, “manufacturers and distributors of food, beverages, and tobacco, as well as producers of nondurable household goods and personal products.” It is not diversified just as XLP and XLY are not. The expense ratio is 0.22% with a turnover of 12%. Though XLP and VDC are not guaranteed to make money during a recession, they are also less likely to lose it. This is important because money lost needs to be regained to make the portfolio whole again. If the loss, the drawdown, is 50%, the gain needs to be 100% to come back to sum zero.

Another way to go basic is to invest in large US stock indexes, for example, Vanguard 500 Index Investor Shares (VFINX); expense 0.15% and turnover 5.5%. This is because they are better suited to withstand tight money, varying earnings, and uncertainty for the future than smaller stocks. These are companies with strong balance sheets, a seasoned business plan and a long track record. What could be more basic than that? In addition, 35% of large US stocks have business abroad, another advantage in a US recession.

This is because other countries need not be affected by our recession or at least not to the same degree as we are. We export to other countries and as our dollar slips, as it has, our product is more appealing to foreigners because it is less expensive for them. If they buy more from us for this reason, it can only help us. Therefore, increasing international exposure may be helpful. An example of a broad international index fund is Vanguard Total Intl Stock Index Investor Shares (VGTSX). It is composed of three underlying Vanguard funds.

If doing all or some of the above sounds a bit daunting, things may not be as difficult as they seem. Although it's true the news is blasting recession, in part because it gets our attention, we have not met the criteria for this potential unpleasant event according to one commonly used definition. It is: recession is a decline in a country's gross domestic product (GDP) for two or more successive quarters.

Our GDP is not there yet, thank you. It rose a 0.6% annualized rate last quarter and had a 4.9% gain in the third quarter. With interest rates declining, the GDP could rise above 0.6% this quarter rather than going lower. If so, we won't meet the measure for recession as given above.

Uncertainty regarding a looming recession is painful. But, knowing what to do, if we think it will happen, makes it less so. As Warren Buffet says, "Look at market fluctuations as your friend rather than your enemy; profit from folly rather than participate in it."

About Shirley M. Mueller, MD

Dr. Shirley Mueller is a physician turned financial consultant and investment educator. She teaches others how to invest their own money using a Noble Prize-winning financial strategy. Her fee is hourly, not a percentage of assets. She welcomes comments at [ShirleyMMueller@MyMoneyMD.com](mailto:ShirleyMMueller@MyMoneyMD.com). For more information, visit her website at [MyMoneyMd.com](http://MyMoneyMd.com)

