

With a combined 50+ years of experience, 2X Wealth Group is committed to educating and empowering investors. We firmly believe financial literacy helps people make better decisions.

How Do You Protect Your Portfolio in Uncertain Times?

There is no 'one-size fits all' answer to this question. Every recession or bear market is driven by a unique set of events, and the portfolio strategies that work best depend on the specific causes and the prevailing political and economic circumstances leading to the downturn.

The classic financial advice is to diversify your portfolio. However, diversification alone does not eliminate risk. Past recessions—including the dot-com bust in the early 2000s, the financial crisis in 2008–09, and the COVID-19 pandemic in 2020—show that the best portfolio strategies were not all the same.

1. The dot-com bust was driven by excessive technology stock valuations, and portfolio protection came from over-weighting value, mid and small cap stocks. These stocks outperformed tech for almost 10 years. Given their lower valuations at the time, it makes sense that value stocks (which were largely outside the tech sector) had a period of outperformance. Treasury bonds and gold served as safe havens and appreciated as investors sought safety.
2. The financial crisis of 2008–2009 was precipitated by weak lending standards and the packaging of mortgages into risky securities. Banks were at the center of the crisis. In this case, the value sector - which includes a large percentage of banks and financial companies - underperformed the general market. Once again, Treasury bonds and gold provided safe havens and appreciated. Federal Reserve actions to lower interest rates and purchase Treasury and Mortgage-Backed Securities further benefited the bond market.
3. The 2020 recession was caused by the Covid-19 pandemic - an unexpected non-financial catalyst. In this case, both stock and bond markets briefly went into free fall. Cash was a stabilizing asset, and gold briefly rallied at the onset of the crisis. Once again, the Federal Reserve dramatically lowered rates, and the U.S. government also provided fiscal stimulus by putting money directly into citizens' pockets. In this scenario, Treasuries rallied on lower interest rates and growth stocks soared.

4. In 2022, high inflation and Federal Reserve actions to slow the economy by raising interest rates caused a bear market in stocks. When inflation expectations climb, bond yields rise as investors demand higher returns to compensate for this risk. Rising yields push bond prices lower. So, in this case, Treasuries did not provide a hedge against falling stock prices, much to the chagrin of 60/40 portfolio proponents. 10-year interest rates started the year at extremely low levels (around 1%) and rose to almost 4% by December. One of the best strategies was to own cash instead of bonds (given how low rates were) and to own value stocks instead of growth stocks.

What Is Causing Economic Duress Today?

The current combination of rising tariffs, high national debt and deficits, and limited policy flexibility is rare in U.S. economic history. While the U.S. used tariffs (such as the Smoot-Hawley tariffs) in the 1930s, the world did not have today's globalized supply chains, interconnected economies, or such high debt levels.

Today, the national debt relative to GDP is near record highs at about 100%. The budget deficit over the past year, at 7%, is astonishingly high for a healthy economy. These circumstances restrict the government's ability to respond to economic downturns with fiscal stimulus. The Federal Reserve also has less room to cut interest rates than in previous cycles, especially if inflation remains persistent. This means monetary policy may be less effective in cushioning future shocks. Further, if investors begin to doubt America's fiscal position, it could trigger higher interest rates or a weaker dollar, compounding economic challenges.

What Are the Risks?

We think the two risks facing the economy are either a recession or stagflation (slow growth coupled with rising unemployment and higher inflation). Because of uncertainty about final tariff policies, it is impossible to predict what will happen, but we lean toward a stagflation outcome. Below, we discuss strategies for each of the two scenarios.

Strategies for Recession

- Consider reducing your equity exposure. If you need your money soon, your risk tolerance has changed, or your goals have shifted, it may be wise to reduce your equity exposure. This is especially prudent when U.S. equity valuations are historically expensive, as they are today.
- Shift a portion of your equities into dividend-paying stocks. Dividend-focused stocks emphasize companies with a history of returning cash to shareholders. This steady income stream can help cushion your portfolio during periods of volatility, providing tangible returns even when stock prices fluctuate. Unlike the financial crisis, we don't expect banks to be at the center of the problem; their balance sheets are in better shape, and they have been more conservative in their lending standards.
- Buy bonds. To fight a recession, the Federal Reserve will lower rates and possibly buy bonds, in which case bond prices would rise. However, this time, bonds may not help as much as they have in the past, due to the high level of U.S. debt and uncertainty about the willingness of foreigners to buy our debt (especially after the sting of tariffs).
- Hold cash. In a recession, with falling inflation, cash can stabilize your portfolio. The downside to cash versus bonds in a recession is that your money market yields will fall as the Federal Reserve cuts interest rates.

Strategies for Stagflation

Tariffs can drive up prices while slowing growth—a tough combination for policymakers to address. But certain portfolio strategies can help.

- Consider changing the nature of your equity exposure. Similarly to the recession strategy, shift a portion of your equities into dividend-paying stocks. While dividend-paying stocks may decline, they should fall less than the broader market.
- Buy commodity stocks. In slow growth, inflationary environments - especially with supply shocks such as those caused by tariffs -real assets tend to outperform. The specific type of commodity stock will vary with the political environment. In the late 1970s, it was an oil supply shock caused by an embargo, a problem we don't see currently. Today, we are more concerned about agricultural commodities and rare earth minerals.
- Buy gold and gold stocks. Gold is not tied to the credit risk of any institution, is highly liquid, and offers diversification benefits since it often moves independently of stocks and bonds. Gold is a safe haven in an environment marked by geopolitical tensions, trade disputes, and a weakening dollar. Gold and gold stocks have already rallied substantially this year and may consolidate in the near term before resuming their upward trajectory.

Beyond its role as a hedge in a stagflationary environment, gold is particularly interesting today if we are on the cusp of a shift in the global monetary order. To correct distortions in the global financial system and reprice real assets, we may see a significant devaluation of the U.S. dollar relative to gold.

If you'd like help thinking through portfolio adjustments or risk management strategies, we're here to help!

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