

Protecting Your Nest Egg in a Recession

By Laura Bruce

Nov. 12, 2007--Anyone nearing retirement is old enough to remember the recession of 2001.

While the experts were debating whether the country really was in a recession -- and if so, when it would bottom out and when the recovery would start -- your portfolio was probably losing value.

It's rotten enough to see your nest egg decimated when you have 10, 20 or more years for it to recover.

But millions of Americans on the cusp of retirement experienced the devastating effect of a recession on their portfolios just prior to, or shortly into, their retirements.

Now, six years later, the news is peppered with stories of a slowing economy and talk of a possible recession. If retirement is in your near future, or even if it's years off, consider taking steps to protect your assets against a potential downdraft in the stock market.

We spoke with two money managers, Dean Barber, of Lenexa, Kan., and Alan Lancz, of Toledo, Ohio, who talk about what they're doing for their clients.

In his own words: Alan B. Lancz

Alan Lancz is president of Alan B. Lancz and Associates, a money management firm in Toledo, Ohio. Lancz says one of the key factors in a successful portfolio in any type of economy is managing risk. He has also taken the unusual step of fully disclosing to his clients, on a real-time basis, the holdings in his personal and retirement portfolios, and his company's corporate holdings.

It's important be strategically in the right areas or sectors of the market. In May, we recommended selling the real estate investment trusts (REITs), utilities and financials. The financials comprise more than 20 percent of the S&P 500. If you look back at 2000, technology was over 20 percent, and whenever you get a sector that comprises so much of the market it's usually a concern, a red flag should go up to investors.

They've gone down quite a bit, so it's not as worrisome, but in our estimation there's too much uncertainty. We don't know if another shoe will drop as far as subprime. Usually when there's fallout that will take longer -- just like with technology, it took more than a

year for the sell-off to correct all the excesses in technology -- and we kind of see that with the financials, so it's an area that we would still avoid.

Being in the right areas and, if we're looking at potentially a recession or at least an economic slowdown, being in more defensive areas is important.

We're right now underweight on consumer discretionary mainly because a lot of the economic growth has been the consumer, and with the problems with housing and credit concerns, we think it will be much more difficult for the consumer to be the main catalyst for the U.S. economy. We're overweight on more defensive issues such as health care, telecom and technology. And we're equal weighting consumer staples.

Be proactive, not reactive

It's more a matter of being in the right companies. Even in technology we're overweight, but our overweight is from a year ago. We plan on selling, and that's my second point: being proactive rather than reactive. What I mean in that regard is we recommended selling the financials and REITs and the utilities in May -- we're going to be selling into the technologies because all of a sudden technology has become a safe haven because it doesn't have the subprime and credit concerns.

If there is a recession, we'll definitely see an economic slowdown that's going to affect technology, too, but investors, with their myopic view, aren't looking at that. They're just looking at, well, you know, there are some hot products that don't have any credit concerns with subprime and this is the sector to be in.

Look overseas

International is another example. If you talk with other advisers, that's probably going to be their No. 1 answer -- go internationally if you see an economic slowdown or recession in the U.S. That concerns us a little bit. We've been overexposed internationally for most of the last seven years. It initiated with us buying a lot of the infrastructure plays after seeing the growth in some of these BRIC (Brazil, Russia, India and China) countries. We've been taking profits in some of those the last year or two and buying more defensive plays in (global consumer staples and pharmaceuticals).

International is a good way to participate as far as outperforming a slowing U.S. economy, but it's to the point that most advisers are saying 20 percent of your portfolio should be international. That concerns us. You have to look at the market globally, but it's not a panacea that you just have international and it will cure all the problems. Just like being in the right areas of the U.S., you have to be in the right areas globally. But that's one way to help the investor who might be close to retirement or retiring and worried about a recession.

Two common mistakes

When we get new clients, they often have a great portfolio in terms of great companies. But the two mistakes we see is whenever the bank trust or whoever managed it before we got their money, they just bought a selection of high-quality companies and they didn't

really look into the price or valuation, they just bought across-the-board, good-quality issues. So, 20 percent or so of those companies will be overvalued because they were bought at or near their highs and are now historically high-valued.

But the biggest mistake we see, and why a lot of new clients come to us, is that they never sell. Buy and hold is becoming outdated. It's easy for the adviser or the trust company or the mutual fund manager to do it from the standpoint of just buying across the board and just hanging on.

It reminds me of the index funds. You're buying 500 companies in the S&P 500 and whether there's an Enron in there or whatever, you're holding it until you're forced to sell or S&P has finally decided to eliminate it from the index.

Remember to take profits and redeploy them into lesser-risk, low-expectation areas. The best example of what we're doing now is in the energy sector. It's been very hot so we're overweight, but we're decreasing our overweighting. If you still want energy exposure and income, sell some of the high-flying energy companies that have done so well and buy some of the leaders in natural gas.

For the long-term investor, it's a nice way to reduce risk in one area that's done so well for years and still participate in the energy sector, but with less risk.

Cash and CDs

Cash is important and it's part of profit-taking. For example, when we take profits in tech, as it becomes more and more favorable, if we don't find other places to redeploy those assets we'll put it in cash. And if you're close to retirement, having that cash or fixed-income component is going to be critical.

I think (high-yield) CDs are a good route. I wouldn't do Treasuries because the flight to quality this summer has depressed those yields. High tax-bracket individuals should select high-quality municipals. They're at historically high yields now compared to what you can do with a CD.

If we're not finding the bargains to redeploy as we're taking profits in these areas that are moving up, our cash just automatically builds up. If a client is closer to retirement and more conservative, there will be fewer bargains to buy because we're not going to buy aggressive-growth-type companies, so their cash would build up more quickly than an average investor or younger investor.

The other big mistake I see the average investor making is not being aware of cost or risk. If you're in a quasi-index fund, make sure you don't have extra fees and costs. What I've seen throughout the country is people selling these good, low-cost funds and then charging 1 percent or 2 percent to asset allocate them. That means you're getting an index-type performance, but now you've guaranteed yourself the cost of the fund plus the 1 percent or 2 percent you're paying an adviser. So, you're guaranteed to underperform the market by 1 percent or 2 percent. If you can get active management for that, why are

you paying for an asset allocation? If you can put together your own group of mutual funds and avoid the added cost, many times you're going to be better off.