How to shelter from market storms

Market corrections do happen. The key is how to stay financially dry.

Summary: When markets do correct, as they invariably do, it's important not to overreact. The best strategy is to stick with your long-term investment plan, and use any downturn as a potential buying opportunity.

Key take-out: Keeping a cash buffer in place is a sound strategy to ensure any markets dips do not impact your normal cash flow.

Billionaire investor Warren Buffett once described the stock market as a highly efficient mechanism for the transfer of wealth from the impatient to the patient.

It's sage advice, from a market sage. And when does impatience really play out? Invariably it's when markets take a dip, and the herd mentality kicks in as investors sell into the panic.

The smart, and sensible advice is not to get sucked in, and to stick to your long-term strategy. But that's not always easy, so having some back-up financial plans in place makes a lot of sense.

If you are retired and living from your investments, over the last decade you will have become very used to a return of around 10 per cent.

Based on my usual advice to draw down 5 per cent per annum, those who have been taking $50,000 per $1 million over this period have had the great joy of seeing their investment capital barely fall, despite the Global Financial Crisis. (I refer to this as the '**Magic Pudding' effect**, where you get to eat into your investment and the market replaces it).

I also advise retirees to make sure they are invested in index funds which track the market (exchange-traded funds). Historically this has proved to be a good proposition.

Stay away from excessive financial commentary – keep a cash buffer

Buying index funds also means you are locked into the rise and fall of markets, so my advice is always to switch off from the market noise. It is about as stressful as it gets if you ride every bump and jolt the

market delivers on a daily basis.

You can also set up a wealth-proofing strategy which has stood the test of time. It entails nothing more complicated than keeping an equivalent of two years' income in cash.

There is no need to sell assets when they are falling in value. Just switch to living off the cash buffer, plus the income on your existing portfolio. This simple strategy provides very effective insurance against a market break, and was exactly what got many through the GFC with no medium- to long-term losses.

You don't have to be on the breadline to use a Centrelink strategy

Designed to provide an effective social cushion to ensure that no pensioner in Australia should starve, Centrelink remains the ultimate insurance for retirees against a market downturn. Depending on how much money you have, if the market falls you may temporarily become eligible for a part pension – or even a full pension.

Whilst many are uncomfortable at the thought of applying for an Age pension, implementing a Centrelink strategy can cushion the impact of a downturn.

Remember that a combination of around $300,000 invested, being drawn down at 5 per cent (or $15,000 per annum) plus a full pension of $603.40 per fortnight for each member of a couple, means an annual tax-free income of around $46,375.80.

This isn't a bad position to be in, particularly if you own your own home. In the meantime, less income is required to be drawn down from your portfolio until the market stabilises and eventually recovers.

Similarly, homeowner pensioners in financial duress have the option of taking out a reverse mortgage to help them out; if structured correctly, this won't affect pension entitlements.

A buying opportunity

If your retirement savings are still in accumulation phase you should consider market corrections as a great opportunity to buy good stocks cheaply.

These are the times to increase your super salary sacrifice contributions up to the maximum of $25,000 per annum. If you have access to cash, now is probably a good time to make additional non-concessional contributions. Under the new regulations from 1 July 2017, the contribution cap is $100,000 per year, or up to $300,000 using the 'three year bring forward rule'.

So buying cheaply is a great way to maximise the medium- to long-term rewards from this approach.

Don't take a short-term view

By staying with your strategy and not buying into market hysteria, you are way more likely to improve your financial position over the medium and long term.

Make sure you are invested in low-cost index funds. Following a passive approach will provide you with additional insurance.

The main message is not to fear market downturns. Take sensible precautions to make sure you are not being excessively exposed to a few 'picked' stocks or industries – and keep a cash buffer. Keep your eyes on the medium- to long-term strategy so you don't get distracted by the highs and lows.

Theo Marinis