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Voices: Ted Feight, On Taking the Fear Out of Investing

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I use a buy and hold strategy with one exception: I get my clients out of the market during crashes, recessions or times of extreme volatility and get them back in once the market stabilizes. I've had to do this every eight years or so.

For over two decades, I've relied on special market indicators to warn me when a recession or crash is on the horizon — and the system has never failed me.

The first indicator is when an inverted yield curve lasts for 30 days. This signals that the Fed sees trouble on the horizon. Specifically, I look to see if the three-month and two-year interest rates on Treasury Bills are higher than 10-year interest rates. At that point I usually have about a year to prepare my clients to get out of the market, and I send out the first of three newsletters preparing them for the transition.

The second indicator is if oil prices go up 80% on the first day of the month over what they were the year before. That's another sign that there's trouble ahead. I usually use this second indicator as a confirmation of the first.

Our normal equity allocation is 80% of the total portfolio, with the other 20% in fixed income. The equity allocation is further split 50/50 between U.S. and foreign stocks. If the first indicator shows up, I tighten stop-loss orders on the U.S. stocks to sell at about 15% — down from its original 25% stop-loss. If the first two appear, I bring stop-loss orders down even further to 10-12%. If individual stock holdings drop more than a given percentage, they automatically sell and the money is reinvested in a client's money market. I believe that investing without stop-loss orders is like playing Russian roulette with three rounds in the chamber instead of one.

The result: When my clients look at a graph of their investments during a recession or market crash, they see a straight line. Psychologically this is huge, and it prevents the vast majority of my clients from panicking or deciding it's time to find a new adviser.

Knowing when to get back into the market is a little bit trickier. Historically, if the S&P 500, the NASDAQ and the Dow are down 20%, the economy has hit rock bottom. That's true 95% of the time, so that's when we get back in. The problem is that last 5% of times when it's not true. In the recent recession, we got back in a few months too early — August 2008. Fortunately the stop-losses that I had set in place when the indicators first went off were automatically triggered within the next couple months when the market started to dip again. We were back out before our clients suffered any huge losses. Our more conservative clients didn't lose anything, and clients who wanted to get back into the market more aggressively kept their losses between 3 and 17%. Compared to the 40-50% market drop, that's pretty good.

No strategy is perfect, but if my clients are sleeping soundly I know I'm doing something right.

