4 Ways To Weather An Economic Storm

by Andrew Beattie (Contact Author | Biography)

Economic conditions can be as temperamental as the weather. In this article we'll look at some simple steps that can help keep the financial boat afloat during an economic tempest.

Batten Down the Hatches
Warren Buffet derides management that embarks on cost cutting, as good management shouldn't need to be prompted to control costs – that should be second nature. People are less strict with their personal finances than Buffet is on management, but a downturn quickly provides the motivation needed for cost consciousness. There is always room for cutting frivolous expenses, or at least substituting them with cheaper alternatives. This applies to everything from the morning coffee to landscaping the backyard. (To learn more about the "Oracle of Omaha," check out *Think Like Warren Buffet*.)

Set in Stores
Even if you have creditors banging on your door and ringing you at work, your first priority should be building or augmenting your emergency fund. When money is consistently flowing out of your bank account leaving a near-zero balance, there is no cushion for unexpected and unavoidable expenses - like a root canal or a new radiator. This forces people to take on yet more debt to make ends meet, and the outflow of cash worsens until it seems like they are working just to satisfy their creditors. The better alternative is to make minimum payments on your debt while building a cushion of at least one month's wages, but preferably 3-6 months.

The larger the emergency fund, the more secure you'll be mentally and financially. With three or more months in reserve, it takes a pretty big emergency to shake things up. Building the fund should take precedence over investment as well as debt payments. Any automatic investment plan should be put temporarily on hold and that money funneled towards the emergency fund to help speed up the building. It may feel like you're dodging creditors and robbing from your golden years, but with a proper emergency fund, you'll be in a better situation to consistently make payments on your debts and regularly invest no matter what happens in the future.

Patch the Hull
When the general market is choppy, there is almost daily coverage of where the hot money is going. Investors rush out of cash and into bonds; out of bonds and into stocks; out of stocks and back into cash and bonds, and on and on. Rather than getting caught up in the stutter-step of fast money, most people would benefit far more from paying down existing debt than finding safe havens to park idle funds.

If you are holding debt during a downturn, paying it back is one of the few places where you can put your money that will guarantee a return no matter what the market is doing. The return on paying off a 5% loan is, of course, the 5% you are no longer being charged. With some credit companies charging in the high teens and twenties, you'll likely outstrip the S&P 500 and your own portfolio simply by getting that future interest off your books. (For more, read *Expert Tips For Cutting Credit Card Debt*.)

Check the Charts
When the economy is disrupted, the value of stocks in your portfolio will also be whipsawing. Although you don't want to make rash decisions during economic downturns, recessions and slumps are very informative on the whole. In good times, mediocre and even weak companies can prosper, so hard times act as a baptism of fire for all stocks. Therefore, there's a lot to be learned from how a company reacts to a downturn. Companies that continue to profit - or at least lose money at a slower rate - in a downturn can often take advantage of depressed prices to expand their businesses and snap up assets on the cheap.

Cash on hand, much like your personal emergency fund, is one measure of how vulnerable a company is when profits slump. Companies that perpetually overextend themselves in good times are easy to spot, as they languish and burn up their cash reserves in hard times. If you already have a regular schedule for checking into your holdings, don't change it because of an economic dip. Do, however, note how they are handling things and whether or not cash reserves are being used up. If you still like how a company is acting, it's a good time to get more on the cheap. If the downturn has uncovered some dogs, then why hold on when you could do better things with the cash that's tied up?

Conclusion
One of the biggest temptations is to reverse all your preparation when the economy recovers. Economists sometimes call this spending binge "pent up demand." As things improve, there seems to be less need to have large amounts of cash in reserve, or to keep to a strict budget. There is also a tendency to mindlessly push money back into the market to make up for lost time and value, sometimes leading to an echo bubble. If, however, you can continue to run a tight financial ship, you'll find that your superior reserves, cost consciousness and contrarian thinking will keep you sailing smoothly in all manner of economic seas. (For more on this topic, check out *7 Lessons To Learn From A Market Downturn* and *Adapt To A Bear Market*.)

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