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# Strategies for Different Cycles

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Wise investors alter their approaches as market cycles shift, from bull to bear to something in between. A consistent strategy is far more risky than one that involves tactical shifts according to the season.

Take my 13-year-old son, who loves wearing shorts and a T-shirt. He loves this so much that he wears the skimpy attire all year-round, no matter how cold it is outside. He does this for two reasons:

1. That is the style now.

2. He is 13 and just doesn't know any better.

He reminds me a lot of how individual investors behave. They follow a traditional asset allocation/buy and hold approach, regardless of what the market is doing. This, and any other strategy, works fine in a bull market, just like wearing shorts and a T-shirt is fine during the summer. But it gets you crushed in a down market.

There are three different types of markets, each requiring its own investment strategy:

**1. So-easy-a-caveman-could-do-it market**. In such bullish times, the market goes up in a straight line. Even someone with a brain the size of a walnut could make 20% per year. (apologies to any cavemen reading this, if you can read, that is). The 1995-1999 tech-boom market is a great example. In this type of market, anything that you invested in works very well. This is true with an asset allocation or a trend-following tactical strategy.

**2. Bear market**. This is one that goes down a lot. Great examples of this are the 2000-2002 and 2008 markets. Any strategy that has you fully invested gets hurt in this type of market. This is just like my son wearing shorts in the dead of winter: He feels comfortable because everyone is doing it, but he is freezing his butt off. In this market, the only strategy that works is one where an investor is in cash and bonds.

**3. Risky market.** Here, volatility is high, which produces some returns but is at great risk of falling into a slump. The current cycle, 2011 and 2012, embodies this. While the market has gained, the risk is still immense. Volatility is low at the moment, yet any bad news from anywhere – Europe is a big source of it lately – will change that in a jiffy. Although a fully invested strategy in this market could work out OK, the risk is not worth it. This is like my son wearing shorts in the fall: If he gets a warm day he is fine; if he doesn't, he gets real cold.

Tactical is still the way to go in this market. A good tactical strategy often trails a fully invested approach if the market is going up in the face of great risk (albeit with much less volatility). But it protects you if the risky market turns bearish.

With this strategy, known as Tactical Asset Allocation, you alter the mix of your assets based on their price performance. You favor asset classes trending upward, and unload those going down.

TAA has two methods: *Relative strength*, also called momentum, has you buying the strongest investment from a basket of two or more asset classes. That could be stocks and bonds, or U.S. shares and international ones. *Counter trend analysis* entails buying into short-term weakness and selling into short-term strength.

This is not market timing, which involves predictions. Market timing tries to get out at market tops and in at market bottoms. TAA only moves when a trend is clear.

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