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Submitted by Matthew Tuttle on Fri, 07/27/2012 - 12:00pm

Investors, fearful that the market is headed for more tough times, are favoring defensive stocks, which happen to throw off nice dividends. Is this the way to protect yourself? No. Go to cash.

An article [1] in last Monday's *Wall Street Journal* noted that, since the market began losing altitude in April, defensive sectors are all the rage: telecom, utilities, healthcare and consumer staples. Presumably, if another economic downturn occurs, people still will need to make calls, light the house, go to the doctor and eat food.

Defensive stocks change hands for 15 times projected 2012 earnings, and more cyclical ones, 12 times. The WSJ piece points out that utility company **Wisconsin Energy** (WEC [2]) has a 3% dividend yield, more than twice that of a 10-year Treasury bond.

I have written about dividend stocks before and probably will again. The bottom line is this: If you want to be defensive, you move to cash. That is the only thing where you have a guarantee that you will not lose any money.
Why don't investors do this? Two main reasons:

1. Sales sizzle. Wall Street is compensated when it convinces people to buy stocks. To do that, the Street must build up an attractive story for these stocks – such as, defensive sectors shine during bear markets.

This ignores the fact that, if the market drops 10% to 20%, you will probably make money in Treasuries and get crushed in dividend stocks. In crisis-ridden 2008, the **Utilities Select Sector SPDR** (XLU [3]), an exchange-traded fund that tracks that defensive sector, fell 29%. Yes, it lost less than the wider market (the Standard & Poor's 500 [4] dropped 37%), but the hit was pretty severe.

If you left your money in the bank, you lost 0%.

2. Wall Street says: Do something. Instead of moving to cash during times when the risk outweighs the reward, Wall Street feels that it needs to take action to justify fees. Therefore, they hold their nose and try to find things that are less bad than others. If the market goes down 30% and they only lose 20% that is a success.

So don't fall for the idea that you have to do something, and don't fall for sales sizzle. Sometimes the best course of action is boring. Cash is not sexy. But the key to making money in the market is to avoid large losses, and cash is one of the only things that can promise this.

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