



Recession-Proof Mutual Funds

by Lisa Smith ([Contact Author](#) | [Biography](#))

The [herd instinct](#) kicks into overdrive when [mutual fund](#) investors hear the word [recession](#) and news reports show stock prices dropping. Fears of further declines and mounting losses chase investors out of stock funds and push them toward bond funds in a flight to safety. It's an effective tactic for investors who are seeking to avoid risk and are smart or lucky enough to sell while their portfolios are still on the positive side – but it's not the only strategy available to combat tough times. Read on to find out what else you can do in the face of a recession.

What Bond Funds Have to Offer

There are several types of bond funds that are particularly popular with risk-averse investors. Funds made up of [U.S. Treasury bonds](#) lead the pack, as they are considered to be one of the safest. Investors face no [credit risk](#), as the government's ability to levy taxes and print money eliminates the risk of default and provides principal protection.

Bond funds that invest in mortgages securitized by the [Government National Mortgage Association](#) (Ginnie Mae) are also backed by the full faith and credit of the U.S. government. Most of the mortgages (typically mortgages for first-time home buyers and low-income borrowers) securitized as Ginnie Mae [mortgage-backed securities](#) (MBS) are those guaranteed by the Federal Housing Administration (FHA), Veterans Affairs, or other federal housing agencies.

Next on the list are [municipal bond](#) funds. Issued by state and local governments, these investments leverage local taxing authority to provide a high degree of safety and security to investors. They carry a greater risk than funds that invest in securities backed by the federal government, but are still considered to be relatively safe.

Taxable bond funds issued by corporations are also a consideration. They offer higher yields than government-backed issues, but carry significantly more risk. Choosing a fund that invests in high-quality bond issues will help lower your risk. ([Corporate Bonds: An Introduction To Credit Risk](#) provides information about how to evaluate the risks or investing in corporate bonds.)

While corporate bond funds are riskier than funds that only hold government issued bonds, they are still less risky than stock funds. ([Evaluating Bond Funds: Keeping It Simple](#) provides an overview of some of the key factors for determining a fund's risk-return profile and [Bond Funds Boost Income, Reduce Risk](#) highlights the stable returns these investments can provide.)

Beyond Bonds

When it comes to avoiding recessions, bonds are certainly popular, but they aren't the only game in town. Ultra-conservative investors and unsophisticated investors often stash their cash in [money market](#) funds. While these funds do provide a high degree of safety, they should only be used only

for short-term investments. (To learn more, read [Introduction To Money Market Mutual Funds](#) and [Are Money Market Fund Risks Worth It?](#))

Contrary to popular belief, seeking shelter during tough times doesn't necessarily mean abandoning the stock market altogether. While investors stereotypically think of the stock market as a vehicle for growth, share price appreciation isn't the only game in town when it comes to making money in the stock market. For example, mutual funds that focus on dividends can provide strong returns with less volatility than funds that focus strictly on growth. (To learn more about dividends, see [Dividends Still Look Good After All These Years.](#))

Utilities-based mutual funds and funds that invest in consumer staples are less aggressive stock fund strategies that tend to focus on investing in companies that pay predictable dividends.

Traditionally, funds that invest in large-cap stocks tend to be less vulnerable than those that invest in small-cap stocks, as larger companies are generally better positioned to endure tough times. Shifting assets from funds that invest in smaller, more aggressive companies to those that bet on [blue chips](#) provides a way to cushion your portfolio against market declines without fleeing the stock market altogether.

More Aggressive Strategies

For wealthier individuals, investing a portion of your portfolio in hedge funds is one idea. Hedge funds are designed to make money regardless of market conditions. Investing in a [foul weather fund](#) is another idea, as these funds are specifically designed to make money when the markets are in decline.

In both cases, these funds should only represent a small percentage of your total holdings. In the case of hedge funds, "hedging" is actually the practice of attempting to reduce risk, but the actual goal of most hedge funds today is to maximize return on investment. The name is mostly historical, as the first hedge funds tried to hedge against the downside risk of a bear market by shorting the market (mutual funds generally can't enter into short positions as one of their primary goals). Hedge funds typically use dozens of different strategies, so it isn't accurate to say that hedge funds just "hedge risk." In fact, because hedge fund managers make speculative [investments](#), these funds can carry more risk than the overall market. In the case of foul weather funds, your portfolio may not fare well when times are good.

Diversification: A Strategy for Any Market

While bond funds and similarly conservative investments have shown their value as safe havens during tough times, investing like a [lemming](#) isn't the right strategy for investors seeking long-term growth. Trying to time the market by selling your stock funds before they lose money and using the proceeds to buy bond funds or other conservative investments and then doing the reverse just in time to capture the profits when the stock market rises is a risky game to play. The odds of making the right move are stacked against you. Even if you achieve success once, the odds of repeating that win over and over again throughout a lifetime of investing simply aren't in your favor.

A far better strategy is to build a diversified mutual fund portfolio. A properly constructed portfolio, including a mix of both stock and bonds funds, provides an opportunity to participate in stock market growth and cushions your portfolio when the stock market is in decline. Such a portfolio can be constructed by purchasing individual funds in proportions that match your desired asset allocation or you can do the entire job with a single fund by purchasing a mutual fund that has "growth and income" or "balanced" in its name. (To learn more, read [Managing A Portfolio Of Mutual Funds](#).)

Conclusion

Regardless of where you put your money, if you have a long-term time frame, look at a down market as an opportunity to buy. Instead of selling when the price is low, look at it as an opportunity to build your portfolio at a discount. When retirement becomes a near-term possibility, make a permanent move in a conservative direction. Do it because you have enough money to meet your needs and want to remove some of the risk from your portfolio for good, not because you plan to jump back in when you think the markets will rise again.

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