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Do You Have A Plan For The Next Market Crash?

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Benjamin Franklin put it best when he said, “failing to plan is planning to fail”. While he may not have been referring to investing or the stock markets when he said this; nevertheless, it holds true for investors. First, it helps to define a few key terms because “market crash” may mean different things to different people. A decrease of 10% is considered a “correction”, while a decrease of greater than 20% would be a “bear market”. These definitions are both independent of a “recession” which is generally defined as two successive quarters of declining GDP.

If we are to plan or prepare for any of the above scenarios we also want to know how often they occur. Corrections (10%-19% declines in the stock market) happen on average once per year. In fact, the average intra-year decline in the S&P 500 since 1980 has been 13.8%. Of those 40 years, the S&P 500 finished the year with positive returns on 30 occasions. The dreaded bear market (20%+ decline in stock prices) has tended to happen about once every 3.5 years. It is important to note these downturns do not happen like clockwork, and the timing of a correction, bear market, or recession have proven difficult to predict. This is why it is so important to have a long term plan in place, and stick to it. Here are a few steps you can take to help build a plan for your investments as well as accomplishing your financial goals.

1.) The first step in creating a solid plan is having clearly defined goals. Your goals should be very specific, and have a set time frame at which you want to accomplish them. An example of a common financial goal would be, I want to retire in five years and I will need $X per month to live the lifestyle I want in retirement.

2.) It is also important to take any rule of thumb with a grain of salt. The old asset allocation adage of having your age in bonds may not hold true for most individuals, especially in the interest rate environment we see ourselves in at the moment. Your investment allocation should be fine-tuned to your specific situation. You would want to consider the time frame at which you are investing for, the specific goal at which you seek to achieve, and your unique circumstances along with your personal risk tolerance.

3.) Your personal risk tolerance can be generally overestimated in periods of prosperity and underestimated during times of large market fluctuations. It helps to visualize what that means in dollar terms and to be honest with how that figure makes you feel emotionally. Take a $1,000,000 portfolio for example. A 10% decline may not sound too bad, after all we just established that tends to happen quite

often, but this translates to a $100,000 decrease which may feel very different. Emotional responses can lead to rash choices outside of your original plan. Making any decision in a panic rarely has a positive outcome.

A solid financial plan can be set by yourself or with the expertise of your financial advisor. The general components include establishing clear goals, revisiting benchmarks at set intervals, and clearly assessing your personal situation. With that, you can rest a bit easier knowing you have a retirement blueprint in place.