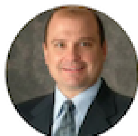
5 Tips To Help You Prepare For The Next Market Crash

May 19, 2020



Mark Avallone, CONTRIBUTOR
I help people on their path to Financial Freedom. FULL BIO
Opinions expressed by Forbes contributors are their own.

Many stock and bond investors were caught off guard by the swift and severe market downturn earlier this spring. At the market bottom, things looked dismal, and many stock and bond investors panicked. Remember, for every buyer there has to be a seller—and there were folks who sold on March 23rd when the Dow Jones Industrial Average hit an intra-day low of 18,213.

Photo Credit – Getty

Chances are these investors were nervous, scared, and likely without a financial plan for how they would feel amidst a full-fledged panic. So here are a few tips to help you prepare for the next (dare I say inevitable) market crash.

Build your asset allocation with the full expectation of a 20% to 30% market decline. After a decade-plus of gains in the stock market, many investors started to consider the stock market a place where annual asset values only increased. The conversations I had with investors in 2009 as we came out of the last crash were filled with caution, but by 2019, most conversations had included hope and greed. As the old saying goes, 'greed eventually replaces fear'. Of course, if you are a long-term investor, and you can absorb the substantial risk-of-loss that comes along with being a stock investor, then by all means continue to consider an all-stock portfolio. But before you do, please understand your true risk tolerance and how you will likely react during a downturn.

Ask yourself the most important question about risk. We use several different 'Risk Tolerance Questionnaires' in our practice, but they aren't always perfect tools. In fact, I have anecdotally found an

accurate risk assessment is simply to ask the investor: "how would you feel if you were invested in stocks and your account dropped by 30%?" And then I put a dollar figure to it, which makes it more real and more tangible. If the answer is full of emotion, fear, and a willingness to sell at such a depressed level, then I know that regardless of the questionnaire results, I am not talking to a high-risk investor. So, ask yourself that same question, applying whatever amount of money you have to invest. If the thought of losing 30% of it makes you nauseous, then consider lowering your percentage allocation to stocks.

Check your portfolio for sector concentrations. In the stock market crash of 2000, tech stocks led the decline. In the 2008 market debacle, banks were the big losers. Now, in this 2020 bear market, energy, travel and leisure stocks are among the worst performers. Because we don't know the nature of the next correction, we may want to be careful about significantly over-weighting our favorite sector. That includes technology. Sure it looks like a smart place to be and it has been doing very well, but piling all your money into one sector doesn't always pan out very well.

Examine the quality of your bond portfolio. In this recent downturn, investors learned that not all bonds are created equally. In fact, for example, one may take comfort in a 50% stock and 50% bond allocation. But when that bond segment is overweight in high-yielding, lower quality bonds, there may be little-to-no protection. That is because high yield bonds, or 'junk bonds', tend to correlate to stocks, and when the risk hits the fan these investments often behave poorly. So while high-quality investment-grade bonds may seem boring during a 'risk-on' period, they may look a lot better when the story deteriorates.

Keep some cash available to invest. The great investor Shelby Davis famously said "you make most of your money in a bear market—you just don't realize it at the time." Anyone who bought stocks in late 2008 or early 2009, can attest to this. So, it may be wise to keep some cash on hand to go bargain hunting during declines. Of course, as noted above, this step should be taken only if it allows you to remain within your desired asset allocation range and risk tolerance.

Bear markets can create pain, but they also bring opportunity for the well prepared. Investing with the knowledge that corrections can be severe and violent will reduce your emotional response. This will help you keep a clear head about strategically investing and accumulating positions at perhaps even more favorable entry points. And if the emotional roller coaster of investing is just too much for you to get your arms around, seek out a trusted, knowledgeable advisor who can help guide you through the tough times.

Contributor's Bio

Mark Avallone is the author of Countdown To Financial Freedom, and founder and President of Potomac Wealth Advisors, LLC a financial advisory firm serving clients through holistic financial planning and wealth management. Avallone writes on a variety of financial topics, and his contributions have appeared in the Wall Street Journal as well as in Forbes where he is a regular contributor. He has appeared on CNBC and has been a repeat guest on the Fox Business Network. His insights have also appeared in USA Today, U.S. News & World Report, The Washington Post, and other leading publications.

Securities and advisory services offered through Commonwealth Financial Network®, Member www.FINRA.org/www.SIPC.com, a Registered Investment Adviser. Fixed insurance products and services offered through Potomac Wealth Advisors, LLC or CES Insurance Agency. 15245 Shady Grove Rd., Suite 410, Rockville, MD 20850