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How to Make Sure Your Retirement Nest Egg Is Safe from Another Black Monday

On Oct. 19, 1987, known as Black Monday, the stock market took a nosedive, with the Dow losing 22.6% of its value. Even cautious investors saw their retirement savings go up in smoke. Are you prepared for another such catastrophic event?

Brian O'Connell | Oct. 21, 2017

On Oct. 19, 1987, known as Black Monday, the stock market took a precipitous and fierce nosedive. Even cautious investors saw their retirement savings go up in smoke. With markets at all-time highs, many are fearful we could see another massive correction ahead.

As part of TheStreet's series "Crash of '87 -- TheStreet Special Report" we ask you: are your assets allocated properly to weather another such catastrophic event?

Black Monday still remains the biggest on-day market crash in Wall Street history, with the Dow Jones Index shedding 22.6% of its value, about $500 billion overall-- the equivalent of a 5,000-point drop in the Dow today.

By contrast, the U.S. stock market had been performing like gangbusters in 1986 and 1987, rolling along behind a burgeoning economy and robust corporate profits. Traders, brokers and analysts who were on the job that day, regularly interacted with clients who were shocked the market could collapse in such a spectacular fashion and were stunned to see so much money pour out of their investment accounts so swiftly.

Fast forward to 2017, and some of the same elements are in play right now on Wall Street.

Think about it. A strong economy, sturdy corporate financial performance and a booming stock market are the three-legged stool where retirement investors comfortably sit, not realizing that a Black Monday-like market collapse could kick that stool out from under them, just like on Black Monday.

"If history is any indication, the stock market corrects about 10% every year," says John Bodnar, founder and chief executive officer of Bodnar Financial Advisors, Inc. in Florham Park, N.J. "A much larger correction of 20% to 30% occurs every five to six years on average. The last big correction was the financial crisis of 2008 and 2009, and that was almost a decade ago. We are way overdue."

That outlook might be hard to fathom, given that the S&P 500 hit 36 daily highs this year, through September, and that the Dow Jones Industrial average crested 41 daily highs of its own.

But why take a chance? Maybe market experts like Zandi are wrong, or maybe they're right. The key for long-term, retirement investors is to be prepared for a significant market downturn and have their portfolios insulated against a Black Monday-like stock market collapse.

"As someone who lived through the 2008/2009 economic crisis working in New York City, this market makes me very nervous," says Michael Ruzhansky, a financial planner with Iron Dome Financial Group, LLC, in Princeton, N.J.

Ruzhansky says he's already begun rotating clients into more defensive and less aggressive positions. "At the very least, we're having these conversations," he states. "The rest depends on the individual fact pattern."

"For example, I don't recommend making strategic changes in portfolios for Millennials and Gen X/Y clients unless they need liquidity," he adds. "But I recommend a more defensive tilt for someone closer to retirement. The problem is that traditional fixed-income investments do not produce enough income, so retirees are forced to stay in the market to keep up with inflation."

Other investment professionals urge retirement investors not to panic and to stand strong and stay the course in the event of a market downturn.

"Leave your portfolio alone," says Anna Dunn Tabke, director of research at Alpha Capital Management in Atlanta. "Making short-term investment decisions based on recent market movements is a recipe for disaster."

Tabke says that investors should be forward-thinking, anyway, and carefully assess how much money they are willing to lose in their retirement investments before a market downturn happens. "This is a key ingredient in determining their asset allocation, including what percentage of their money is in the stock market," she explains. "Once that allocation is set, the investor must be disciplined to stick with it through a downturn - otherwise, he or she runs the very real risk of selling at the bottom and taking too long to reinvest, therefore locking in losses and failing to participate in gains."

One other specific step long-term investors can take to wall themselves off from any big market setback is to evaluate their investment risk scenario.

"I know investors get tired of hearing about risk tolerance, but it really does play a big role in the success of an investment strategy," says Erika Jensen, president of Respire Wealth Management LLC in Houston.

Jensen says that investors are aggressive as long as the market is going up and are very conservative suddenly when the markets go down. "Right now, the market is very likely overbought," she says. "I've been keeping an eye on overall volume. The market is moving higher on relatively low volume, which could indicate that institutional investors are not buying and that there's quite a bit of greed on the part of retail investors. There's also really low volatility as the market seems to do nothing but go up regardless of what headlines we see in the news."

But does that mean everyone should start selling out? Jensen doesn't think so. "We don't know we're at the top of the market until we can look back with 20/20 vision and say, 'O.K., that was the top,'" she adds. "Selling now could mean missing out on additional upside for investors."

Visualizing a significant market decline - and how a long-term investor would react to that event - is also a useful tool for retirement savers looking to protect their portfolio assets.

"As a recent retiree and former investment manager who lived through Black Monday, I would advise investors to first imagine what their financial situation would be if the stock market suddenly dropped 25-30% and prepare for that scenario," states William Worsley, author of the book Investing in Vain. "If their routine spending would be significantly affected, they should take steps to reduce their risk now because the U.S. stock market is overpriced by many measures."

On the other hand, if those investors can handle the hit because their assets give them sufficient cushion to withstand a major drawdown that might last for a few years, Worsley advises them to stick to their long-term investment plan. "Dial back your stock exposure modestly, but stay invested," he says. "A well-diversified investment portfolio and sound investment plan should incorporate the assumption that very painful bear markets will occur every few years, followed by market recoveries."

Also, note that history - especially stock market history - has a way of repeating itself. "Remember that Black Monday was followed by a rapid stock market recovery, and that was followed by the roaring 1990s," says Worsley. It was also followed by robust recovery in retirement savings portfolios.