A Crash Will Come. And That’s OK.

Trying to prepare for the next cataclysm could mean missing some of the market’s best days

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A crash is coming.

Relax, it probably isn’t imminent. For something so infrequent, though, the “c” word is awfully good at grabbing investors’ attention. This Tuesday is the 90th anniversary of the granddaddy of them all, Black Tuesday, so it is natural to dwell a bit more than usual on the timing of the next wealth-destroying cataclysm.

There were U.S. stock market collapses before 1929, of course, such as the Panic of 1907, which also reached a crescendo in October. And by far the largest single-day crash of all happened in October 1987. Anyone sense a pattern? Well there isn’t one, but the coincidence has unfairly given October a reputation as a risky month to be in the market.

So what is the secret to profiting from a crash? One tried and true method is boldly predicting that there will be one and charging people for your insight. Roger Babson pioneered the practice with his 1920s newsletter making predictions that he claimed were based on Newtonian physics.

"Sooner or later a crash is coming, and it may be terrific," he famously said weeks before the 1929 break. His reputation and fortune were sealed, despite the fact that he had made several gloomy predictions before.

Elaine Garzarelli, who nailed the 1987 crash in a TV interview, became the best-paid strategist on Wall Street and still profits from that call despite a spotty record overall. Her newsletter will set you back $495 annually and "due to the long term nature of some of our recommendations, there are no refunds on the price of the subscription."

Robert Prechter, who claims he predicted the 1982 bull market using an arcane "wave" theory and has since reaped millions of dollars from subscribers, has made several shocking predictions over the years, such as the Dow falling to between 1,000 and 3,000 back in 2010.

"A grandiose, bearish call had about a one-third chance of being right in the past century," estimates Mark Spitznagel, the chief investment officer of Universa Investments, which reportedly made $1 billion during the 2010 "flash crash."
Stuck in the unlucky two-thirds? Fear not: Author Harry Dent, who has predicted booms and busts for decades with stunningly poor timing—for example, his forecast of a 17,000-point drop in the Dow in 2016—now predicts "a major financial crash and global upheaval that will dwarf the 2007-09 recession of the 2000s—and maybe even the Great Depression of the 1930s."

Messrs Prechter and Dent and Ms. Garzarelli didn't respond to questions about their predictions.

Even those who bet actual money correctly on crashes, such as hedge-fund managers John Paulson and Kyle Bass in the housing bust, have struggled after their big scores. Perhaps the starkest example comes from fund manager John Hussman, who anticipated the last two bear markets. His Hussman Strategic Growth Fund has given back all of its gains after prematurely bearish bets. A $10,000 investment in the fund made 19 years ago would be worth around $9,300 compared with $32,000 put in an S&P 500 index fund.

Mr. Hussman, a former finance professor, says “a decade of deranged monetary policy amplified speculation and disabled its limits,” bringing his preferred valuation measures near “1929 extremes.” He continues to expect a steep market loss as the market cycle is completed.

“I hope readers will time-stamp this story and save it for their children as a cautionary reminder, not of the danger of anticipating market collapses, but of the danger of declaring victory at halftime,” Mr. Hussman said.

If one were at all timely in predicting a decline as big as 1929’s—a gut-wrenching 89%—then the benefit to long-run returns would be tremendous. That is a big “if.”

“It’s fundamentally a fool’s errand” to try to predict a crash, says Mr. Spitznagel, whose fund profits handsomely by betting on such “black swan” events.

That seems like an odd thing for someone who effectively peddles crash insurance to say, but he doesn’t try to predict their timing or recommend dabbling in derivatives. The best way for less-sophisticated investors to prepare—which includes virtually everyone—is to accept that a crash could happen tomorrow.

Trying to sit out a crash often means missing some of the market’s best days—which tend to happen during volatile periods. Putnam Investments calculates that missing just the U.S. market’s 10 best days in the 15 years through 2018 would have cut your ending portfolio in half. Missing the 20 best days would leave you with two-thirds less.

The price of admission to those heady long-run returns is making peace with temporarily losing half of your money.