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# How to Avoid Black Swans

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When it comes to investing, a big obstacle many people face is the fear of catastrophe. If you invest in a stock, there's always the possibility that the value may drop to zero. In fact, we used to have a wall in the office lunchroom that was covered with stock certificates from liquidated companies. Most of those businesses likely had good ideas and solid plans. After all, they had reached a level of success that allowed them to go public. And yet, eventually, each stock certificate was worth only the paper it was printed on.

People have different ways of thinking about financial risk. Some refer to *black swan* events. The term, which was popularized by Nassim Nicholas Taleb's 2007 book, refers to unforeseen events that have a big impact on things like stocks or the market. In 2023, to take one recent example, the stock of Silicon Valley Bank went from $284 to $0.90 in less than a month. If someone held only that stock, they might have called what they experienced a black swan.

I have a different definition for black swans that's rooted in my 50 years of experience as an investor and my optimism for investing in public markets. In fact, I don't think I've seen a true black swan event during my lifetime. Back in the early 1970s, markets were down more than 40%, but they have never gone to near-zero. And when they have gone down, they have eventually recovered.

Of course, some people might think the stock market going down 20% would be catastrophic. Perhaps they are close to retirement and counting on every cent they've saved. That's why people often hold less in stocks relative to bonds as they approach and enter retirement. Remember, investors can control the amount of risk they take by adjusting the percentage of stocks in their portfolios. If half of your portfolio is in stocks and the other half is in less-volatile bonds, a 20% decline in the stock market might reduce the overall value of your portfolio by only 10%. That's one way of protecting yourself against a potential black swan. Indeed, this strategy has helped cushion the blow of many market downturns, making it easier for investors to stay the course and avoid the temptation to sell at the worst possible time.

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Staying disciplined is one of the keys to capturing the market's long-term returns. Over the past century, the stock market has returned on average about 10% a year, which makes sense when you consider the asymmetric nature of stock returns.[1] Remember that while a stock can only fall to zero, losing 100% of its value, successful companies have the potential for gains far exceeding 100%. Take Nvidia, for example, whose stock price has increased by many multiples in recent years. This asymmetry—the fact that winners can gain more than losers can lose—is one of the many reasons I'm so optimistic about investing in public markets.

Because the protection against catastrophe that a diverse portfolio provides is quite different from other forms of risk we experience in life. When you buy the market of stocks, you are buying a little bit of thousands of companies. So it would be like spreading the risk of buying a house among thousands of homes all over the world. Imagine if instead of one job, you had a little bit of thousands of jobs in every sector of the economy. You'd never worry about losing your job.

Holding a market portfolio isn't just about reducing your risk from black swans, however you define them. When you start to feel that you have an investment plan that protects you against catastrophe, you can start to feel better. That's why it's important to have a process you trust, which means a process you understand. Of course, there are no guarantees when it comes to investing. But you can put yourself in a better position to pursue your goals and "win"—in investing and in life.

1. In US dollars. Based on S&P 500 Index annual returns, 1926–2023. S&P data © 2024 S&P Dow Jones Indices LLC, a division of S&P Global. All rights reserved. Past performance is not a guarantee of future results. Indices are not available for direct investment; therefore, their performance does not reflect the expenses associated with the management of an actual portfolio.

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