



Is your portfolio "fail safe"?

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Markets will fall—that's inevitable. What matters is whether your portfolio is designed to meet your goals when they do.

Key points

- **Portfolios don't typically fail because markets fall—they fail because losses coincide with withdrawals.** This "sequence of returns risk" can turn temporary drawdowns into permanent damage.
- **The difference between fragile and resilient portfolios may come down to design, not prediction.** Investors cannot avoid downturns, but they can prepare for them.
- **A "fail safe" portfolio requires diversification and a Liquidity strategy.** Together, these characteristics may help reduce drawdowns and buy time for a recovery, helping investors avoid being forced to sell assets at the worst possible time.

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Introduction

In a 2014 YouTube video, Tom Scott and inventor Colin Furze demonstrate a pair of homemade electromagnetic climbing boots.¹

While using the boots to stand upside down on a magnetic ceiling rig, Tom describes three categories of engineering safety:

- **Fail safe:** A system that defaults to a safe state when something goes wrong. For example, a magnetic door lock that releases during a power outage so people can exit safely.
- **Fail dangerous:** A system that defaults to an unsafe or hazardous state when it fails.
- **Fail deadly:** A system that defaults to the worst possible outcome—such as Cold War “doomsday” mechanisms designed to trigger retaliation after a loss of communication.

As Tom points out, the electromagnetic boots are clearly fail dangerous: If the batteries die, he will fall—directly onto his head.

The key insight is that these safety categories have nothing to do with *how likely* failure is to occur. Instead, they focus on what happens *when it does*.

The same distinction applies to investment portfolios. Some portfolios are built to absorb shocks. Others may appear stable—until stress reveals that they are, in effect, fail dangerous.

Building a fail safe portfolio

Market volatility is inevitable if you want to build wealth—but volatility alone is not what causes damage to portfolios.

The real danger arises **when market losses coincide with withdrawals**, forcing investors to sell assets at depressed prices and lock in those losses permanently. Locking in losses can create damage that compounds, leading the portfolio to dwindle and eventually fail to support spending needs.

This is the essence of **sequence of returns risk**: When poor market returns occur at the same time as withdrawals, temporary losses can become permanent. In this way, volatility can turn short-term pain into lasting damage.

In this sense, a “fail dangerous” portfolio is one that works in good markets, but becomes vulnerable precisely when an investor needs it most.

Bear markets—periods where the S&P 500 index falls more than 20%—are a prominent threat for the average family. Unfortunately, we cannot know when the next bear market will occur. From history, we can see that bear markets have happened on average approximately every 11 years since 1945. This statistic masks a wide range, however; in some market cycles, it has taken only two years from one market peak to the next; in other cycles, the bull market generated over 16 years of consecutive all-time highs.²

Rather than trying to predict when the next market drawdown might occur, consider strategies that may help to build a fail safe portfolio—a portfolio that reduces the risk of needing to sell during a market drawdown.

Diversify risk

The S&P 500 has generated substantial wealth, but it has grown increasingly concentrated in a handful of stocks and sectors, creating potential fault lines beneath the surface. As we discuss in [Why not just own the S&P 500?](#), published 11 February 2026, the S&P 500—and US large-cap stocks in general—face growing headwinds and risks that could hamper their returns going forward.

Diversification may help to reduce the probability and severity of drawdowns—and enhance return potential—by expanding the opportunity set to include international stocks, small-cap stocks, value stocks, and private markets.

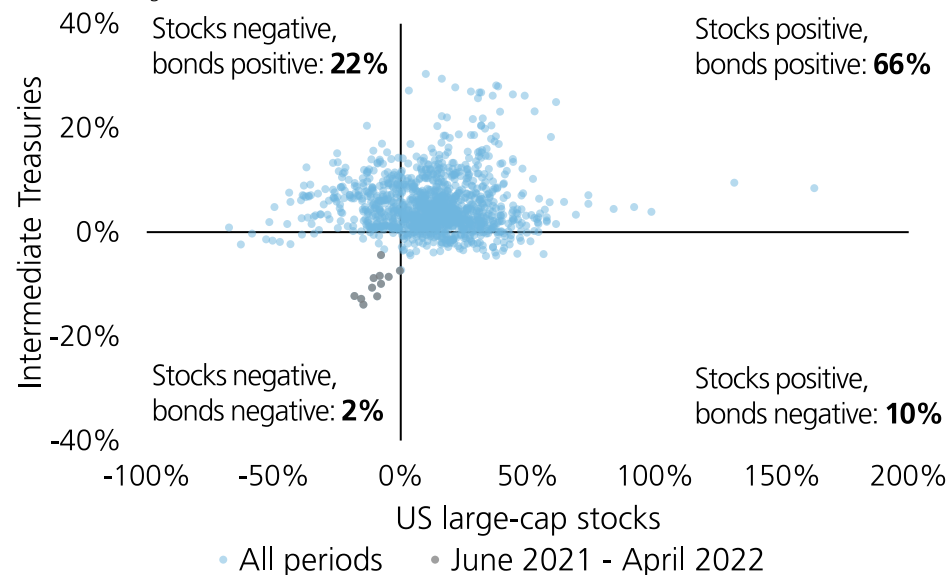
Importantly, diversification extends beyond equities. High-quality bonds have historically provided crucial portfolio ballast during bear markets.

While some have questioned their effectiveness in recent years, Figure 1 illustrates that **stocks and bonds rarely experience significant losses at the same time**. Even including 2021-2022—a notable exception, where a bear market occurred without a recession—bonds have delivered gains in **91% of the 12-month periods when stocks declined**. That consistency has been even stronger in higher-rate environments, with bonds posting gains in **95% of periods when stocks fell and the 10-year Treasury yield started above 4%** (as they are now).

At the same time, bonds have participated in positive markets as well, generating returns alongside stocks in **66% of rolling 12-month periods**. This matters, as it means that bonds are not just a hedge, but a relatively efficient one when compared to hedges that rely on stock market losses to generate gains.

Figure 1 - Bonds tend to provide strong returns when stocks stumble

12-month rolling returns, stocks and bonds, 1926-2026



Source: Morningstar Direct, Bloomberg, UBS, as of 29 May 2026.

Indexes used: Ibbotson Large Company Stock Index (US large-cap stocks), Ibbotson Intermediate Government Bond Index (Intermediate Treasuries). For illustrative purposes only. Past performance not indicative of future results. An index represents an unmanaged universe of securities and is not available for direct investment.

In that sense, bonds remain one of the most reliable tools for stabilizing portfolio outcomes because **they tend to protect when it matters most**. Yet many investors may be underallocated to bonds and hold excess cash that neither meaningfully offsets equity risk nor contributes to long-term growth potential.

Build a Liquidity strategy

Diversification helps to *reduce* risk, but it does not *eliminate* it. Even well-diversified portfolios experience drawdowns. When bear markets occur, most balanced, diversified portfolios have fully recovered their losses within **three to five years**.²

Therefore, a reasonable first line of defense is to build a Liquidity strategy portfolio to fund short-term cash flow needs. Here, cash may play a role—alongside high-quality bonds—to help build a buffer between spending and market risk, buying time for markets to recover and thus reducing the risk of needing to sell long-term investments as a loss. See [How to build a Liquidity strategy](#), published 2 June 2026, for more details.

In effect, a Liquidity strategy helps to create a "fail safe" portfolio by ensuring that market stress does not automatically lead to harmful decisions.

Conclusion

A fail safe portfolio is not one that avoids losses. Risk is the price of admission for long-term returns. Instead, a fail safe portfolio is designed so that *when losses do occur, the outcome remains manageable*. This philosophy helps to shift the focus from *predicting* markets to *preparing* for them.

Diversification may reduce the likelihood and severity of market shocks, while a Liquidity strategy aims to ensure that shocks do not force unfavorable decisions. Together, they help investors avoid the most damaging scenario: turning temporary drawdowns into permanent impairments.

Ultimately, portfolio construction is not about avoiding failure altogether. It is about ensuring that when failure does happen, it does not cascade. That is the difference between a portfolio that can fail dangerously and one that is designed to fail safely.

End notes

¹ Scott T. Fail-Safe vs. Fail-Deadly (with Colin Furze) [Video]. YouTube. June 9, 2014. Accessed 4 June 2026. Available at: <https://www.youtube.com/watch?v=TUKQfMFKfjk>.

² UBS. (2024). How to manage risk in a bear market. UBS Global Wealth Management. Available at: www.ubs.com/bearmarketguidebook.

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