Market Insights

What to make of stocks entering bear-market territory

Investors with a 50-year investment horizon will live through, if history is any guide, 14 bear markets over the course of their investing lives.[1] That's a bear market once every 3.57 years.[2] History would also suggest that during those bear markets, investors should expect their equity portfolio to lose, on average, 32% (median 28.8%).[3] It's almost enough to make investors wonder why they put money in equities at all. Yet, stocks, as represented by the S&P 500 Index, returned, on average, 10.5% per year over the past 50 years.[4] That's a doubling of their investments, on average, every 6.9 years, notwithstanding all the bear markets.[5]

At times like these, there is a tendency to focus on what we want now, instead of what we want most. For many of us, what we want now is safety for our loved ones and for our investment portfolios. Still, what we want most is long-term financial security. We know that equities, more than any other asset class, have historically been the greatest wealth compounder. Therein lies the rub.

Timing the market is nearly impossible

It's important to use historical facts to overcome emotion. Most investors, by now, have seen the research demonstrating that missing the best 10 days in the market over a 20-year period would cut their returns in half while missing the best 30 days would actually lead to negative long-term cumulative return.[7] Alas, most promoters of that research fail to communicate the most important points: 1) Fully half of the market's best days in history have happened during bear markets and, 2) Another 30% of the market's best days have happened in the first two months of a recovery.[8] In short, timing the market is often a fool's errand, particularly during the depths of extreme pessimism.

The 20-year period from 1998 to 2018, which included the tech wreck, the Sep. 11 terror attack, the global financial crisis, the European debt crisis, Brexit, and many infectious disease scares (H1N1, SARS, Ebola, and MERS) and the S&P 500 Index still climbed 7% per year.[9] A $100,000 investment in the market in 1998 would today be worth over $400,000.[10]

We will get through this by applying the same key principles we have applied in each of the other crises and bear markets of our multi-year investment horizons: think long term and stay the course.

Source: Invesco Canada blog, Insights, commentary and investing expertise, Brian Levitt | March 12, 2020
https://blog.invesco.ca/make-stocks-entering-bear-market-territory/

When will stocks recover?

The four stages of (most) bear markets.

Stage one is *recognition*. Almost everybody shrugs off a bear market's initial slide as being an ordinary event. The markets rise, and they fall. Treating every bad week as the bear's arrival would not only shred one's nerves, but would cause poor performance, should the investor act upon that instinct. Nine times of out 10, realizing a quick 5% or 10% loss would result in a permanent 5% or 10% loss, as stocks quickly return to their previous level.

This market achieved stage one during its third week. Stocks were up slightly for the year, before suddenly dropping 11% in the last week of February. In response, advisory firms issued reassuring notes about how these things happen, and market volatility is natural. The stock market surged the following Monday, failed to hold its gains, and then collapsed in week three—that is, last week. The bear was on.

Stage two is *panic*. This occurs when shareholders realize that the standard advice failed. Buying on the dip wasn't easy money, as it is nine times in 10. Rather, it led to greater damage. Along with the pain (and regret) of unexpected losses comes the surprise that the conventional wisdom was wrong. Investors' faith is tested—and some are found wanting. They sell first, then ask questions later.

We are currently in stage two. It could hardly be otherwise. Along with 1987's bust, the current stock market crash—it fully deserves that name, with the Dow at the time of this writing being down 34% from its peak—has been the fastest stock-market descent since The Great Depression. It is difficult to apply rational analysis when so much happens, so quickly.

The view from the bottom

Stage three is *stabilization*. Stocks halt their decline, thereby ending the impression that they will do nothing but fall. The panic subsides but the situation remains grim. Investors believed during the first stage that stock prices slide on a whim. Now they realize that equities stumbled for good reason, and that until that reason is eliminated, they will continue to struggle. Shareholders' losses will not soon be recouped.

This period is marked by turbulence. Stocks rally, sometimes furiously, only to be knocked back down. Investor sentiment varies between guarded optimism that the end is at least remotely in sight, and despair that the hope was false. This is typically the bear market's longest period, extending for several months. (Several years for The Great Depression, but we do not wish to emulate that example.)

Stage four is *anticipation*. This is when stocks start their recovery. As with the bear market's beginning, almost nobody recognizes its end until after the fact. The news at the time tends to be almost unrelievedly grim, accompanied by articles about how stocks' golden days have passed. However, some investors perceive economic improvement distantly in the future. They make their bids, and stocks begin to rise.

A classic case occurred in March 2009. The recession was in its terrifying midst. Real U.S. gross domestic product declined that quarter, and the next quarter, and the quarter after that. The Morningstar Ibbotson Conference was held that month to empty seats, with the keynote speaker predicting several more months of equity losses. The rally began the next day.

Source: Morningstar, COVID-19 Insights https://www.morningstar.ca/ca/news/200726/when-will-stocks-recover.