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Characteristics of Bear Markets

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It's been 10 years since the last bear market, commonly defined as a sustained decline of 20 percent or more. We experienced a significant correction late last year, with stock dropping almost, but not quite 20 percent. Equity prices have since staged an impressive recovery so far this year. While we don't know if the next bear market is right around the corner or a long time away, to successfully navigate the next one and keep their investment strategy intact, investors need to know three things:

Most Bear Markets Occur in a Recession. Going back to 1945, eight of the last 10 bear markets happened while the economy was in a recession.

Not surprisingly, the stock market's decline is deeper and lasts longer when the economy is in a recession. During recessions, the median stock market decline is 32 percent and lasts for 17 months. During economic expansions, the median market decline was much less, 21 percent, and last and lasted only six months.

The Stock Market is a Leading Indicator of the Economy's Direction. The US economy and the stock market are both cyclical, but the stock market typically turns before the economy. The stock market usually peaks six to twelve months before the economy peaks and begins its descent. When the economy is in recession, the stock market usually bottoms and begins recovering three to six months before the economy begins growing again.

Investors should not make investment decisions based on the economy. For example, an investor who sees the economy doing poorly might be tempted to reduce their stock allocation. Unfortunately, by the time the economy turns over, the stock market has likely already been headed down for some time and much of the downturn may have already taken place.

Conversely, an investor will sometimes say they are waiting for things to 'look better' before investing again. But since the market often begins to rise three to six months before the economy starts to improve, they often miss some of the strongest months in the market if they wait until the economy 'looks better'.

Bear Markets Are Not Straight Down. The typical bear market is not a single 20 percent drop. Instead, bear markets are usually a series of drops and partial rallies. Rallies during bear markets can last for weeks or months and may recover

much of the decline from the previous drop. These rallies can give investors a false sense that the bear market is over, only to see the market turn down again and go lower than the previous drop.

Market are a lot more volatile during bear markets, both up and down. It’s not surprising that nearly all of the 10 worst days in stock market history occurred during bear markets, but many of its best days also occurred in bear markets.

These volatile movements can be emotionally difficult for investors. That’s why it is important for investors to have a long-term investment strategy that they are comfortable with for both up and down markets. Knowing some of the characteristics of bear markets ahead of time can help investors prepare themselves to remain steady through the emotional roller coaster of a bear market and achieve their long-term financial goals.

To watch a video about this topic, click here [1].

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