Zacks INVESTMENT MANAGEMENT

Mitch on the Markets

The (Not So) Looming Stock Market Crash

By Mitch Zacks
Portfolio Manager

Many investors are fearful of the next market crash. When will it happen? How big will it be? Will my retirement savings be at stake?

These concerns are certainly understandable, considering that the 2008 Financial Crisis is still visible in the rearview mirror. But, it turns out that investors are a lot more worried than they should be. If we define a stock market crash as a single-day event where the market precipitously falls, we find that these crashes are actually quite rare. Looking at declines in the magnitude of the October 1987 drop (-22.61%) or "Black Monday" in October 1929 (-12.82%), Yale researchers William N. Goetzmann and Robert J. Shiller along with Case Western Reserve's Dasol Kim, found that there is a *less than 1 percent* probability of an extreme stock market collapse in any six-month period.

With that in mind, the next statistic might surprise you…

Since 1989, those researchers (Shiller in particular) have been tracking the judgments of individual and institutional investors on the probability of a severe market crash. In other words, over the past two-plus decades he's been asking investors if they think a stock market crash is likely ahead.

From all the data that he collected, he found that investors, on average, said there was a 19% chance of a one-day market crash in the next six months. This means that investors pegged the likelihood of a crash at ***20 times*** the historical precedent.

Investors are more fearful of a market crash than they should be. Are you that concerned too?

Too Much Noise

The researchers were curious where this additional concern/fear was coming from, and their argument here might not surprise you at all – they cited the negative influence of the news media on investor behavior. The researchers argue that journalists can "frame recent events through selective reporting –

emphasizing negative outcomes." Go figure.

It's no secret that excitement, negativity and scandal are what sell newspapers – not optimism. In the financial news community, it's almost always about looking for the next shoe to drop. News reporting is more often about what is going wrong or what could go wrong, versus all of the factors that are going well. If you did not hear too much about the solid corporate earnings rebound at the tail end of last year, and how *that* is also playing a role in the stock market rally, then you see my point.

Case in point: Shiller and company used *Wall Street Journal* articles to test their theory, measuring the influence of word choice and subject matter on investor expectations of a crash. They searched articles for negative terms like "crash" and "bad news," and then they did the same for optimistic phrases like "boom" and "good news." Their data confirmed what most would have suspected: "*articles with "crash" and related terminology correlated with higher investor expectations of a stock market crash in the succeeding six months.*"

Bottom Line for Investors

Avoid snap judgments and watch less financial news!

Of course, I'm not advocating you receive less information. I'm just proposing you receive less *bad information.* And there is a lot of it out there. A daily diet of CNBC will make most investors want to duck, cringe, and rethink their entire portfolio strategy. But, most of the time we should be doing none of those things.

As has been the case for most of the last eight years, many of the fearful headlines have not amounted to much. China's hard landing? Forgotten. Europe's sovereign debt crisis? Not as bad as many expected. Brexit? The markets rallied in the months after it. You can go on and on, and in each of those cases there was a slight hysteria in the financial news media, but the stock market found a way to keep climbing. I'd expect the same to be the case in 2017.

-**Mitch**

About Mitch Zacks

Mitch is a Portfolio Manager at Zacks Investment Management. Mitch has been featured in various business media including the Chicago Tribune and CNBC. He wrote a weekly column for the Chicago Sun-Times and has published two books on quantitative investment strategies. He has a B.A. in Economics from Yale University and an M.B.A in Analytic Finance from the University of Chicago.

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