Mitch on the Markets

Why I'm Rooting for a Market Correction

By Mitch Zacks
Portfolio Manager

Many readers likely did a double-take after seeing the title of this week's post. Maybe you thought, wait a second – *Mitch Zacks is actually rooting for a market correction? Since when do we want the market to* ***go down****?*

Let me set the record straight. I dislike market corrections just as much as the next guy. Corrections are almost always scary, sudden declines in the market that are surrounded by bad news and ominous forecasts. Not fun. And for investors who dread market corrections, you are not alone – studies have shown that investors dislike losses *about twice as much* as they enjoy gains.

That all being said, I have also been a professional investor for the better part of 25 years, so I know that market corrections are a normal, healthy part of bull markets. Since 1980, the S&P 500 has experienced an average intra-year decline of -14.1%. That is not a small number, and it speaks to how frequently investors have to cope with declines. I've certainly seen a lot of them over the years, and they rarely come without challenges to your patience and fortitude.

With the market's strong run since the election (up around 10% as of this writing), and given the fact that we have not seen a real market correction of -10% or more since last January, I think it could be a good time for the market to reset a bit.

Three Reasons I Think a Market Correction Would be Positive

1) **Reset Investor Sentiment –** bull markets like to feed off skepticism. In a sense, it keeps the bull market going. Legendary investor Sir John Templeton once said, "*bull markets are born on pessimism, grown on skepticism, mature on optimism and die on euphoria.*" I'm not saying we're approaching euphoria and the end of this bull market. But, I do think that the strong run in stocks has many investors gaining confidence and pursuing risks they might have otherwise shunned. When that happens, it puts some upward pressure on asset prices and makes stocks expensive. A market correction

can help reset those confidence levels and re-introduce a bit of healthy skepticism into the markets – paving the way for the next up leg.

2) **Valuation Adjustment –** stocks are trading at about 18x forward 12-month earnings, which is to say that stocks are not exactly cheap. But, I would also not consider them overly expensive either, especially with the expectation that corporate earnings should post a solid rebound over the next couple of quarters. With a market correction, valuation multiples could come down a notch or two while earnings post solid numbers – a combination that could make for attractive entry points on many stocks.
3) **Give the Bull Market Some Fresh Legs –** one of the defining features of market corrections, in my view, is how quickly the market recovers once the correction has run its course. Often times we observe a "v-shaped" bounce off the bottom of a correction, with the market eventually eclipsing its previous high and finding new highs in a relatively short period of time. In 2016 for instance, the S&P 500 gave up about 11% from January to mid-February, but by mid-March it had recouped all those losses and barely looked back all year. It finished the year up almost +10%.

Bottom Line for Investors

Hopefully by now readers understand that I don't *really* want the market to go down, but I know that it has to eventually. If the market only went up, that would not be normal. In fact, an overheated market would start to turn me bearish, as I would suspect that the growing "euphoria" could only signal the next market collapse.

The thing for investors to remember is that market corrections are normal, routine features of bull markets. They simply come with the territory. When the next one arrives – and it could be soon – I'd encourage investors to try and see it as a positive occurrence. In my view, it means the market is behaving normally. And that's a good thing.

-**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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