Mitch on the Markets

The Next Bear Market Will Come Without Warning

By Mitch Zacks
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March 9th marked the nine-year anniversary of this bull market, which now stands as the second longest bull market in history (the 1990 – 2000 bull market is the longest) according to Strategas Research. Using history as a guide, we know that bull markets do not last forever. Stocks are likely destined to decline materially when a bear market takes hold. The question is, *when?*

No one can say for sure. Again though, if we're using history as a guide, chances are that the next bear market will take hold with very few warning signs, and could very well occur when investors least expect it. Zacks Investment Management remains optimistic for 2018 – our forecast for rising stock prices this year has not changed. But, given this bull market is long in the tooth, interest rates are on the rise, and tariffs are a bubbling theme in the global economy, investors should proceed with heightened awareness.

Lessons from History

The statements I make below about bear markets are general in nature. No two bear markets are the same. In fact, they are often times very different, ranging in duration from just a few months (1987 crash) to several years (1937-1942 Depression into WWII), and in magnitude from around -20% (1956, 1966, 1990) to -86% (1929-1932). The average bear market for the S&P 500 was about -40% over less than two years., but generally speaking bears since the Depression have fallen somewhere between -25% and -35% over 12 – 18 months[1].

To give you some broad context as to what can trigger a bear market, let's take a look at a few recent examples from history.

November 1980 – August 1982

During this period, the U.S. economy was still feeling strain from the oil price shock in 1979, and inflation was running very high. The economy was struggling, but what arguably triggered the bear market, in my view, was the

Federal Reserve (under Paul Volcker) raising interest rates too aggressively in the fight against inflation, ultimately stifling economic growth even further. The market declined -27%[2].

July 1990 – October 1990

This relatively shallow bear market was, in my view, triggered by an exogenous geopolitical event – the Gulf War – during a time of economic fragility. Oil prices soared, and to boot there were multiple savings and loan bank failures that exacerbated a loss of investor confidence. Panicking in this situation could have been tragic, however – the bear market only lasted about four months and the ensuing bull market still remains the longest in history[3].

March 2000 – October 2002

Most readers likely remember this bear market, which was arguably triggered by wildly high valuations and euphoric investor sentiment (not necessarily in that order). More so than the previous two discussed, this bear market caught investors somewhat by surprise simply because the euphoria blinded many to the bubbling risks of overvaluation. The bull market had been going on for so long, with so much money made by many, that it was difficult to imagine the end. I don't believe we are at that point with the current bull market, but I'd argue that we're headed in that direction.

Tax cuts and 'global synchronized growth' may be the catalysts for euphoric sentiment down the road. Who knows. But if positive sentiment continues to build and stocks continue to climb convincingly, I'd caution investors to keep one eye on these four factors:

- Tariffs potentially leading to trade war
- Rising interest rates leading to an inverted yield curve
- Corporate leverage, particularly smaller, riskier companies being able to borrow at low premiums to the risk-free rate
- Exogenous geopolitical factors, particularly in the Middle East, with North Korea, and Russia

Bottom Line for Investors

While we would love to possess a crystal ball that could tell us when a bear would start and end, we know that will never be the case. Bear markets generally don't come with clear warning signs or signals. But, a key tenet of the Zacks Investment Management philosophy is to prioritize participating in bull markets over attempting to sidestep bear markets. Historically, the gains offered by bull markets far outweigh the losses incurred by bears, and in our view the greatest risk to the investor isn't feeling a bit of a sting in participating in a bear market – it's being out of the market when the next bull takes over.

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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[1] Source: Factset

[2] Source: Motley Fool

[3] Source: Motley Fool