Mitch on the Markets

What These Market Meltdowns Can Teach You About Strategy!

By Mitch Zacks
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Not to be too alarming, but we strongly believe that a bear market is headed our way.

We do not think it will happen in the next six or even twelve months, and no one can say for sure when it will occur or what will actually cause it. In my opinion, the only thing we can say with certainty is that a market meltdown of some kind is bound to happen, and history suggests it will most likely take investors by surprise.

Does that mean it's time to move your portfolio into a defensive posture? Far from it, in my view. I think investors would be better served preparing for the inevitable by taking the simple, effective step that has withstood the test of time in my experience: **diversifying**.

A properly diversified portfolio, in my view, means *managing portfolios in such a way that you can weather the downturns while helping you participate in solid long-term gains over time*. Preparing for the next big market downturn doesn't have to be complicated.

A Brief History of Financial Crises – Causes and Market Impact

History is one of the most useful tools investors can use to guide the investment decision-making process. History gives us context and reminds us how markets typically behave, both in good times and bad. I think looking back at past crises – and the impact they had on markets – offers a valuable reminder of everything stocks have been through over time to get to where they are today. Spoiler alert: **stocks have been through *a lot.***

Do you remember where you were – and how you felt – when these crises occurred?

Black Monday, October 19, 1987:
S&P 500 Performance: -22.61% (DJIA)
What Happened: Most remember Black Monday as the day that stock markets across the world crashed in utter panic, like a dark wave that crashed across the world. Causes for the crash are still debated today, from the impact of program trading to international disputes about

exchange rates and interest rates, and fears about inflation. Once the selling started, however, it turned the reins fully over to investor psychology (panic selling).[1]

1998 Russian Financial Crisis, August 17, 1998:
S&P 500 Performance: -19% (from early July to mid-August)[2]
What Happened: As was the case with many crises in the 1990's, this one was related to currency devaluations, this time with the Russian government's devaluation of the ruble, where they also defaulted on massive amounts of debt.[3] Combined with the collapse of Long-Term Capital Management, the stock market felt extreme selling pressure in a short period of time.[4]

Dot-Com Bubble and Crash, 2000 - 2002
S&P 500 Performance: -44.8% (total loss over 2.1 years)[5]
What Happened: Most are familiar with the rise and fall of dot-com companies that culminated in the March 2000 crash. Internet start-ups were rushing to IPO in record numbers and the supply of shares of companies with no positive cash flow flooded the market.

9/11, September 11, 2001
S&P 500 Performance: Declined more than 10% in a little over 10 days[6]
What Happened: One of the darkest days in American history, the September 11 attacks on the World Trade Towers in New York caused the global stock markets to drop sharply. The attacks caused some $40 billion in insurance losses as well, making it one of the largest insured events ever. The attacks also occurred while the country was already in a recession, perhaps prolonging the recovery somewhat.[7]

Global Financial Crisis / The Great Recession, 2007– 2009
S&P 500 Performance: -50.9% over 1.3 years[8]
What Happened: The benefit of hindsight tells us that the housing market began its decline in 2005, and the subprime losses that followed in the years ahead ultimately led to the collapse of many large financial institutions that were overleveraged. The bricks in the wall started to crumble on September 16, 2008, when large institutions declared bankruptcy and the market plummeted day after day. It was a deep recession for the global economy with millions of jobs lost and trillions shaved off of global GDP.[9]

These are just a few of *many* examples of crises we've seen over the years. In this bull market alone, there's also been the European sovereign debt crisis, the fiscal cliff, Brexit, and more. Looking back at these events shows that stocks are vulnerable to shocks of all kinds, from a wild variety of causes. But in my view, the most important takeaway from looking back **is that at the end of the day, stocks have ultimately pushed higher over long stretches of time – in spite of all the hardships and difficulties.**

In my opinion, history tells us that it is more important to recognize where stocks ultimately end up, as opposed to getting too caught up in everything that happens in between.

Bottom Line for Investors

The last 50 years of history have brought several wars, an oil crisis, multiple recessions (including one that earned the name "The Great Recession"), a dot-com bubble that crashed, a financial crisis that brought down some of the world's biggest banks and destroyed millions of jobs, and one of the worst terrorist attacks in the history of the world (9/11).

Yet over that time, since 1968, the S&P 500 has ultimately risen over +7,000%.[10] The market never moves in a straight line, and over those 50 years there were plenty of sharp, scary drops. But at the end of the day, the market has repeatedly demonstrated its ***long-term resilience* to crises**.

Are we saying to buy stocks for all time and never look back? No! We believe in building diversified portfolios that have equity allocations in-line with an investor's goals, retirement income needs, and risk tolerance. Sometimes that means heavy allocation to stocks, sometimes less. But over time, we believe the growth engine of any investor portfolio will come from ownership of stocks, and we believe that over time the investor that sticks with stocks the longest may be able to achieve the risk-adjusted return they need to build wealth.

More crises are on the way, for sure. But we believe stocks will ultimately do what they've always done – move higher in spite of them.

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.

[1] Wikipedia, July 31, 2018, https://en.wikipedia.org/wiki/Black_Monday_(1987)
[2] Yahoo Finance, July 31, 2018 https://yhoo.it/2KeJN5h
[3] Wikipedia, July 31, 2018 https://en.wikipedia.org/wiki/1998_Russian_financial_crisis
[4] Wikipedia, July 31, 2018 https://en.wikipedia.org/wiki/Long-Term_Capital_Management
[5] First Trust Portfolios https://www.ftportfolios.com/Common/ContentFileLoader.aspx?ContentGUID=4ecfa978-d0bb-4924-92c8-628ff9bfe12d
[6] Yahoo Finance, July 31, 2018, https://yhoo.it/2AqQEsM
[7] Wikipedia, July 31, 2018, https://en.wikipedia.org/wiki/September_11_attacks
[8] First Trust Portfolios, https://www.ftportfolios.com/Common/ContentFileLoader.aspx?ContentGUID=4ecfa978-d0bb-4924-92c8-628ff9bfe12d
[9] Wikipedia, July 31, 2018, https://en.wikipedia.org/wiki/Great_Recession
[10] Bloomberg, https://www.bloomberg.com/

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