Zacks INVESTMENT MANAGEMENT

Mitch on the Markets

Portfolio Manager Investing Insights

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How Long Will This Bear Market Last?

Generally speaking, there are three types of bear markets: structural, cyclical, and event-driven. Every bear market has a unique set of drivers, of course, but throughout history most of them fall into one of these three categories:

- *Structural* – These are bear markets like the 2008-2009 downturn, which are driven by financial bubbles, too much leverage, credit market dislocations, and other structural imbalances.
- *Cyclical* – Cyclical bear markets happen more as a function of the business cycle, when growth leads to inflation, interest rates go up too fast, the yield curve flattens or inverts, loan activity declines, demand wanes, etc.
- *Event-Driven* – These bear markets are triggered by an exogenous event, like an energy crisis, political instability, war, or in the case of the current bear market, a global pandemic.

Looking back at data going back to the 1800's, here's what we know about the relative magnitude and duration of each category of bear market:

	How long did the bear market last (months)?	*How steep was the decline?*	*How long did it take to recover (months)?*
Average Structural	**42**	**-57%**	**111**
Average Cyclical	**27**	**-31%**	**50**
Average Event-Driven	**9**	**-29%**	**15**

Source: Goldman Sachs[1]

It makes sense why structural bear markets tend to be the most severe – they result from systemic issues in the financial system and capital markets, which can take a lot of time and pain (in the form of bankruptcies, restructurings, etc.) to fix. Cyclical bear markets are next, and generally require the business cycle to run its course, for interest rates to fall, maybe some monetary and fiscal stimulus to stoke demand. Cyclical bear markets are bad, but have tended to resolve themselves with time and adequate policy responses.

Last on the list are 'event-driven' bear markets, which throughout history have tended to be shorter, less severe on the downside and take less time needed to recover than 'structural' or 'cyclical' bear markets. This makes sense: in many cases, the global/US economy is in decent or good shape before an exogenous event takes place, meaning that it does not take quite as long for the economy to recover once the impact of the 'event' fades.

In the current environment, for example, millions of jobs were lost very early in the crisis as businesses made fast and severe adjustments to cope with shutdowns and restrictions. But once these restrictions are removed, the lost jobs could return fairly quickly – and arguably more quickly than if this were a structural or cyclical recession, in my view.

To be fair, I think it's important to acknowledge that there has not been an event-driven bear market in history that was triggered by a virus/disease outbreak. I think it's important to hold out the possibility that this event-driven bear could morph into a structural bear if the crisis is not contained by, say, summer. In the meantime, however, I think the sheer size and speed of fiscal ($2 trillion legislation) and monetary (virtually infinite liquidity) stimulus should help keep this bear market in the event-driven category for a few months.

In China, new Covid-19 cases fell sharply by mid-March, with the first day of no new cases reported on March 19 – about two and a half months into the outbreak. As I write this, more than 98% of China's major industrial companies have resumed operations, with 90% of workers back on the job. Shopping malls in Wuhan, where Covid-19 first appeared, opened for business this week after being shut completely for two months.[2] If, in the West, we manage to contain the crisis and the 'curves all flatten' by summer, we could tiptoe back to normal economic activity perhaps by late summer. Time will tell.

Bottom Line for Investors

There is no way to know when this bear market will bottom. But what I can tell you, from a long reading of history, is that *the bear market will likely come to end as the news remains bad and even gets worse.* In other words, I think on day 1 of the new bull market, we will still be reading about job losses, lost profits, and bleak statistics about the pandemic. That's what makes it impossible to predict.

Now that we're in the throes of the bear market, the most important outcome for investors, in my view, is to ensure that you're positioned from Day 1 to participate in the rebound when it occurs. If this is an event-driven bear market, which I believe it is, that rebound could arrive much sooner than many anticipate.

ABOUT MITCH ZACKS

Mitch is the CEO & Senior 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] Goldman Sachs, March 9, 2020. Bear Essentials: a guide to navigating a bear market

[2] The Wall Street Journal, March 30, 2020. https://www.wsj.com/articles/china-gets-back-to-work-while-u-s-extends-coronavirus-shutdowns-11585561393?mod=djem10point

IN FOCUS THIS WEEK

- How could the economic stimulus affect you?
- How is the US economy evolving?
- Inside China's economic bounce-back
- The Fed gets even more power

How the Fiscal Stimulus Affects

The $2 trillion economic stimulus has been signed into law (CARES Act). At 800+ pages in length, it is far too broad for us to really dig into many details here. But what we can share are the parts of the legislation that stand to affect readers the most. First is the rule change regarding Required Minimum Distributions. For 2020, the federal government is eliminating the requirement that retirees over the age of 59 ½ make withdrawals from qualified accounts, like IRAs. Of course, if you still need the money you can take your RMD or any amount out of your retirement account. For those below the age of 59 ½, there is normally a 10% penalty on early withdrawals, but if you can prove a hardship like a layoff or illness you can withdraw up to $100,000 penalty free, with the ability to pay the income tax over three years. The second major feature is the stimulus payment that the government is sending to virtually every adult with a social security number. There will be income limits, however. The $1,200 is for those making $75,000 or less ($150,000 for a couple), and gets phased out above that level. Those with incomes above $99,000 won't receive a check/deposit, nor will couples with more than $198,000 in income.[1]

The U.S. Economy's Evolution in Plain Sight

It's widely known and understood that the US economy has been evolving for some time now. The digital era has ushered in entirely new business models, where retailers increasingly rely on e-commerce for revenues, where companies like Facebook and Google generate enormous profits selling ads online, where people increasingly work on computers and store critical data in the cloud (versus, say, filing cabinets). With restrictions on movement and social distancing policies in place, we're arguably seeing an extreme version of what has already been a longer trend in the economy. Though some estimates show that only about a third of the US labor force can work from home, that number is exponentially higher than it was 10 years ago. And is likely to go higher still. Many retail brick-and-mortar stores, for instance, have been seeing declines in foot traffic for years now, and while sales in those stores go virtually to zero in the crisis, online merchants continue to see activity.[2] As we move forward from this crisis, there will be a new sense of urgency for sectors that had once resisted going online to make the transition.

China Sees Economic Activity Bounce Back

China's experience with Covid-19 will no doubt look starkly different than the West's experience. Because China was able to effectively lock down Wuhan and deploy tens of thousands of tests – while using surveillance technology and AI to track infections and movement – they were able to stifle the spread of the virus after three months. Today, gauges of China's manufacturing activity are showing strong rebounds, and official reports show that traffic in Beijing are close to being back to normal during the workweek (Wuhan's traffic is also increasing, but not as much). Additionally, some 98% of major industrial companies across China have resumed

operations, and nearly 90% of people are back on the job.[3] Shopping malls in Wuhan – the original epicenter of the crisis – also reopened this week. These are positive developments that show the virus can be contained, but China is resuming production in a world that currently lacks demand.

The Fed Gets Even More Power

The Federal Reserve has opened six emergency lending facilities in response to the crisis, providing a means for companies large and small to access liquidity. Before this year, it was largely seen as outside of the Fed's realm to loan directly to businesses, but this crisis quickly erased precedent. Now, Congress wants the Fed to go even further, approving some $454 billion to "reload" the Fed's ability to lend – particularly as banks are reluctant to take risks with such minimal net interest margins (flat yield curve).[4] The Fed is now the lender of last resort, available for loans to businesses and municipalities.

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[1] Business Insider, March 27, 2020. https://www.businessinsider.com/trump-signs-coronavirus-economic-relief-aid-bill-checks-for-americans-2020-3

[2] The Wall Street Journal, April 1, 2020. https://www.wsj.com/articles/coronavirus-pandemic-widens-divide-between-online-traditional-businesses-11585733402

[3] The Wall Street Journal, April 1, 2020. https://www.wsj.com/articles/workers-return-to-chinas-factories-but-coronavirus-hurts-global-demand-11585724711

[4] The Wall Street Journal, April 1, 2020. https://www.wsj.com/articles/after-fed-unleashes-firepower-washington-rearms-central-bank-11585498301

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