What to Expect in a Bear Market

Investors have a few useful tools for understanding bear markets. Experience is one of them – if you’ve lived through many different bear markets, you have likely seen the downdrafts, recessions, volatility, and a general sense of confusion (and sometimes panic) in the media about what’s happening.¹

But it should also be true that you’ve seen – and hopefully participated in – the even stronger bull market that has historically followed. From 1929 to 2021, there were 26 bear markets, which probably seems like a big number. But it’s also true that there have been 27 bull markets over the same period, and they were all bigger than the bear that preceded them. From 1929 to 2021, the average bear market resulted in a -36% decline for stocks, while the average bull market resulted in +114% of gains.²

Experience is key, but knowing what type of bear market we’re in can also help investors understand what to expect. There are three main types of bear markets:

- **Structural** – these bear markets are caused by severe dislocations, typically in financial markets, and are often associated with ‘bubbles.’ The 2008 Global Financial Crisis is an example of a structural bear, which often takes several years to fully recover from.
- **Cyclical** – these bear markets are more closely tied to the business cycle, and often coincide with a peak in profit margins, rising interest rates, elevated inflation, and/or deceleration in economic growth.
- **Event-Driven** – event-driven bear markets are triggered by an extraneous, almost always unexpected shock. The Covid-19 pandemic is a perfect example of an event-driven bear market, as investors quickly anticipate immediate and elevated risks to earnings and growth.

In terms of magnitude and duration, structural bear markets tend to be the most painful. Post-World War II, structural bears averaged about -50% declines over approximately two years, which lines up reasonably closely with what we saw in the 2008 Financial Crisis.

Cyclical and event-driven bear markets, on the other hand, average about -30% declines over
generally shorter periods. Since World War II, cyclical bears have lasted on average a little over a year, while event-driven bears have usually spanned about six months.

In my view, we’re currently in month 10 of a cyclical bear market.

The stock market appears to be pricing in the impact of higher interest rates and inflation on future earnings, which has led to multiple contractions even as earnings have, to date, held up reasonably well. I see stocks anticipating that higher rates, inflation, and a higher likelihood of recession will result in peaking profit margins and corporate earnings, which help explain the greater than -20% declines year-to-date.

There are some silver linings to this assessment, however. The first is that the market’s current declines are in the range of what we’d expect to see in a cyclical bear market, which could indicate that anticipated weakness in corporate earnings and economic growth is largely priced-into stocks at this stage.

The second takeaway is that cyclical bear markets tend not to have the same systemic problems we see in structural bears, the latter of which usually feature tight credit markets and too much leverage in the private sector. In my view, we have virtually the opposite today – U.S. household and corporate balance sheets are strong, jobs are plentiful, and while credit spreads have risen of late, investment-grade corporations still have relatively easy access to capital markets. Banks are also very well capitalized.

While these positive fundamentals do not necessarily ensure the U.S. will avoid recession, I think they do provide a buffer against a mild recession turning into something more severe, which I also think means avoiding the types of declines we might expect from a structural bear market.

Bottom Line for Investors

Over the past 80+ years, the S&P 500 has generated approximately +11% in annualized returns. Most investors would be very pleased with this level of return over the span of their investment lives. This is why it is very important to always remember: this +11% annualized return includes all of the bear markets over the last 80 years.

To be sure, this doesn’t mean investors should set and forget portfolios – there are many ways to control risk and volatility while pursuing alpha over time. But it does underscore the benefit of understanding how bull and bear markets have worked over time, which in the current environment should reaffirm how essential it is to participate fully in the rebound when it happens. And if my assessment that this is a cyclical bear market is correct, it shouldn’t be long.

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.


U.S. Factory Activity Eases in September

In Zacks’s view, we’re at a point in the cycle where “bad news is good news,” since weak economic data could signal a coming peak for the Federal Reserve’s rate hike campaign. Manufacturing data for September gave one such sign, as growth in the sector slowed to its lowest pace in two years. The Institute for Supply Management reported last week that U.S. factory activity fell to 50.9 in September from 52.8 in August, which is the lowest level since May 2020 — when the economy was effectively shut down due to Covid-19. New orders, exports, and employment (hiring) all fell in the month as well, which may reflect some success in the Fed’s efforts to reduce demand in the economy. Less activity and weaker demand have helped ease price pressures, with the ISM’s prices index falling to June 2020 levels. The Fed assuredly takes note of this type of data when making policy decisions, which directionally should be seen as a positive.¹

Weaker Data in the U.S. Labor Market Could be Good for Inflation and the Fed

One of the thorns in the Fed’s side in 2022 has been persistent job growth and abundant job openings in the U.S. economy, which has resulted in above-average wage gains (which is inflationary). The Fed has indicated that higher levels of unemployment may be necessary to ease these pressures, but there is one alternative that may be more conducive to a “soft economic landing”—fewer job openings. In an optimistic scenario, the Fed could theoretically achieve ease wage pressures by reducing the number of job openings instead of slowing the economy to the point of triggering layoffs. At present, there are 10.1 million job openings in the U.S. compared to just over 6 million unemployed Americans looking for work, which marks an “improvement” in August when there were 11.2 million jobs available. This decline came as job growth in August eased from 526,000 in July to 315,000, which while still very strong at least marks a softening in labor market activity.

When is the Best Time to Purchase Tickets for Holiday Travel?

According to analysts and fare-trackers, “now.” Airline and travel prices are already elevated due to soaring post-pandemic demand, the rising price of jet fuel, and other inflationary forces. But these price pressures have been boosted even further by airlines’ efforts to manage schedules and capacity, which is to say, reducing the number of flights in an effort to better serve customers (and perhaps charge higher prices). Prices for travel over Thanksgiving and Christmas are already substantially higher than they were last year. For domestic travel during the week of Thanksgiving, the average airfare costs $468, which is 48% higher than Thanksgiving 2021. For Christmas, the figure is even higher, at $574 or 52% higher than last year. Prices tend to fluctuate, but travelers should remember that average prices go up as you get closer to your travel date. That leaves little wiggle room for this year’s holiday season.²

¹ When is the Best Time to Purchase Tickets for Holiday Travel?
² Weaker Data in the U.S. Labor Market Could be Good for Inflation and the Fed
Should these trends continue, wage pressures could ease which could in turn take some pressure off the Fed.³

**More Positive Developments in the Inflation Fight**

Another factor working in the Fed’s favor is the strong U.S. dollar. The ICE U.S. Dollar Index, which tracks the performance of the dollar against a basket of foreign currencies, has surged over +15% year-to-date through September 30. The dollar has notably reached parity with the euro for the first time since 2002 and has also risen to multidecade highs against the British pound and Japanese yen. Since a strong U.S. dollar lowers the price of imported goods and services while also curbing demand for U.S. exports (and thus potentially slowing economic growth), it can help ease price pressures. There are also less-discussed positive developments in the inflation picture. Rents are falling month-over-month in many major markets, commodities are at a seven-month low and trading far from peaks, retail inventories are soaring, container freight rates are falling sharply, and the U.S. ISM Manufacturing Prices Paid Index is currently at 51.70—down -36.33% from a year ago.⁴
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