

Understanding Bear Markets

A framework for perspective



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In the business world, the rearview mirror is always clearer than the windshield.”

WARREN BUFFET

The terms bull market and bear market are used to broadly describe market momentum as either positive or negative. Undeniably, the markets are currently facing negative momentum initiated by the spread of a disease called COVID-19. Beginning in February, the markets have been reacting to the unfolding news of the escalating impact that this disease will have on our global economy.

During this economic storm, getting a clear view through the windshield to see what lies immediately ahead is difficult. While there are real challenges that we face that are unique to our current circumstance, history can provide us with a perspective that will help us understand the nuances of our impending headwinds.

Historical data helps to corroborate, verify and provide clarity to the stories that we remember in the past.

This is helpful because our memories can be altered by our emotions and other factors such as recency bias. When we speak of a bear market, our emotional memories remember the two most recent bear markets, the financial crisis in '08 and the tech crash of '00. However, if we zoom out and look at a broader set of data, we'll have a better understanding of the various types of bear markets that we have experienced over time so that we have a better understanding of the various ways our current bear market can play out.

Generally, there are specific questions that we would like to know as we enter a bear market:

How long will we be in decline?

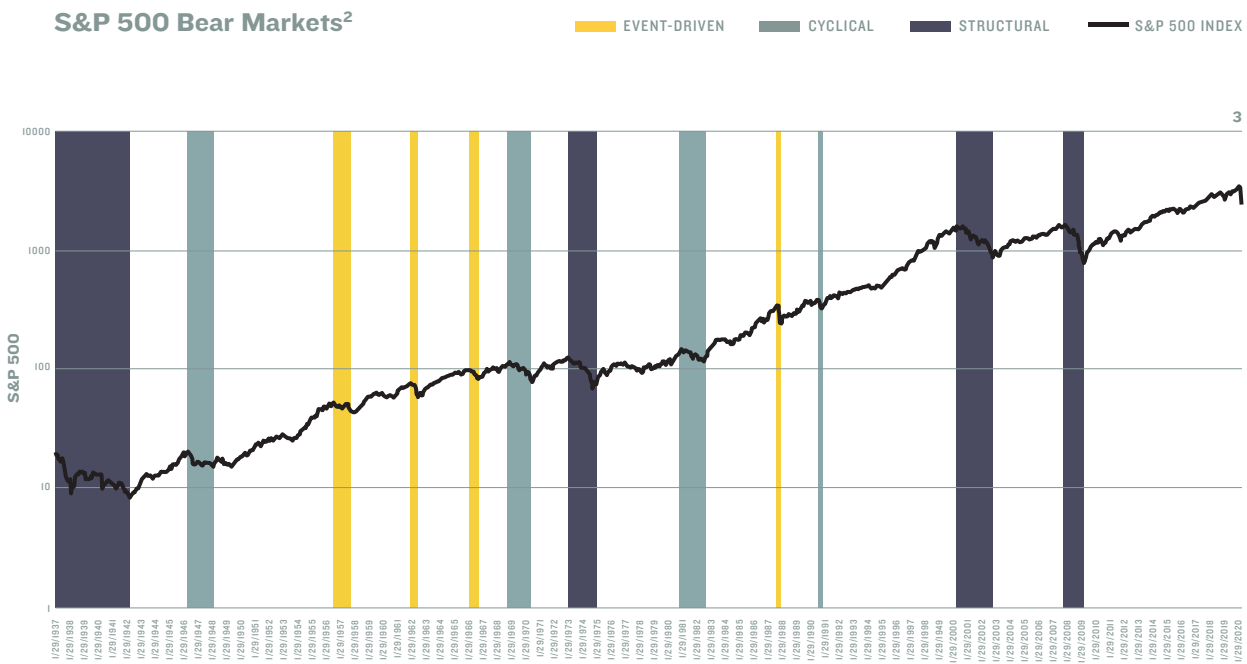
How deep will the loss be?

How long will it take to recover?

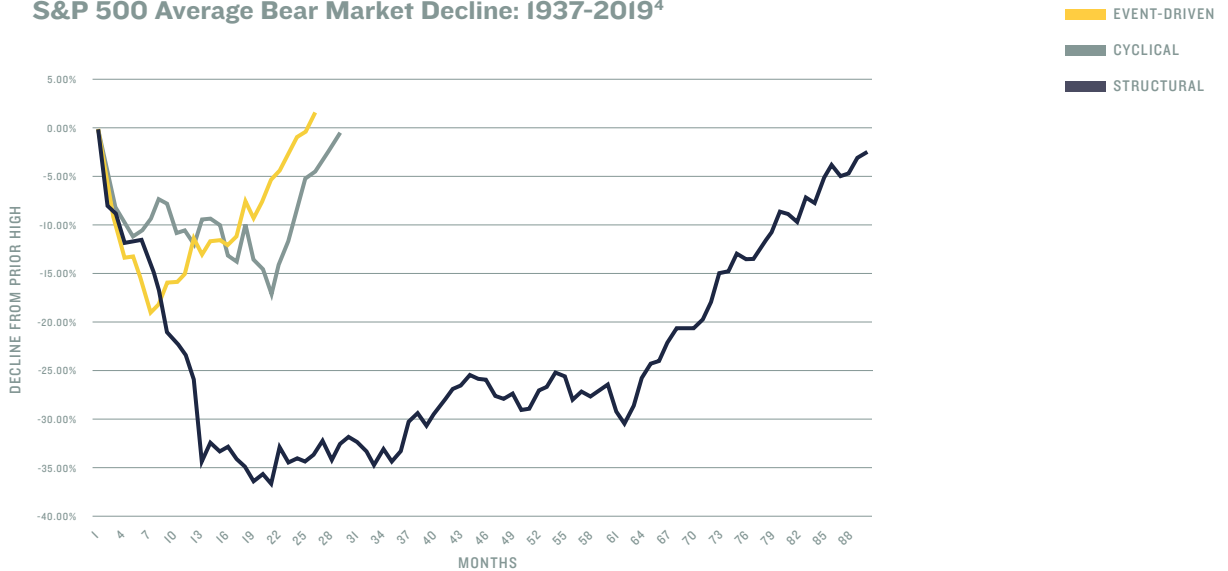
Goldman Sachs has done extensive research¹ looking at historical trends in bear markets dating back to the 1800's. They recognized distinctions and similarities between each of the bear markets and divided them into three categories¹:

1. Structural bear market
2. Cyclical bear market
3. Event-driven bear market

Using Goldman's research¹, let's look at each of the bear markets that have occurred since 1937 categorized by structural, cyclical or event-driven and see how deep the declines were, how long the declines lasted, and how long it took to recover. There have been 12 bear markets identified since 1937⁵. Of the twelve bear markets **4 have been structural, 4 have been cyclical and 4 have been event driven.**



S&P 500 Average Bear Market Decline: 1937-2019⁴



Structural bear markets are the worst bear markets in every regard: They last the longest, they have the largest declines and they take the longest to recover. These bear markets often occur as a result of a bubble that is formed from market prices severely separating from real economic value. The great depression, the tech bubble and the financial crisis of '08 are all examples of structural bear markets that were caused by market bubbles.

Time to reach bottom: 4
21 months
 Decline: **36.82%**
 Recovery: **89 months**

Cyclical bear markets are the most natural bear markets that occur with the flow of the business cycle. The expansion that occurs during the business cycle is tempered by rising interest rates in order to avoid over-inflation. While these are natural occurrences of the economic cycle, the recessions and falls in profits that follow are still painful.

Time to reach bottom: 4
21 months
 Decline: **17.27%**
 Recovery: **29 months**

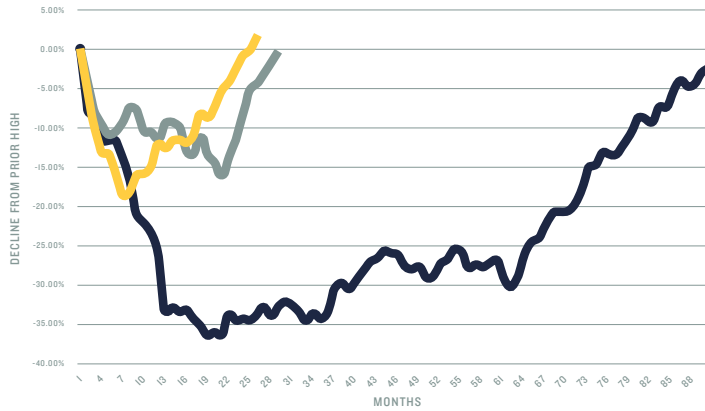
Event Driven bear markets are often sudden and unforeseen. Examples of events that could induce a bear market are wars, political policy changes, and other unpredictable occurrences. These bear markets are often sharp and swift, with the shortest recovery times.

Time to reach bottom: 4
7 months
 Decline: **19.11%**
 Recovery: **25 months**

Considering the historical data in the rearview mirror provides us with a more precise understanding of the wide range of possibilities that exist on the roads that we see through our windshield. Those imminent roads may very well look like one of the three lines on this chart:

S&P 500 Average Bear Market Decline: 1937-2019 Repeated

- EVENT-DRIVEN
- CYCLICAL
- STRUCTURAL

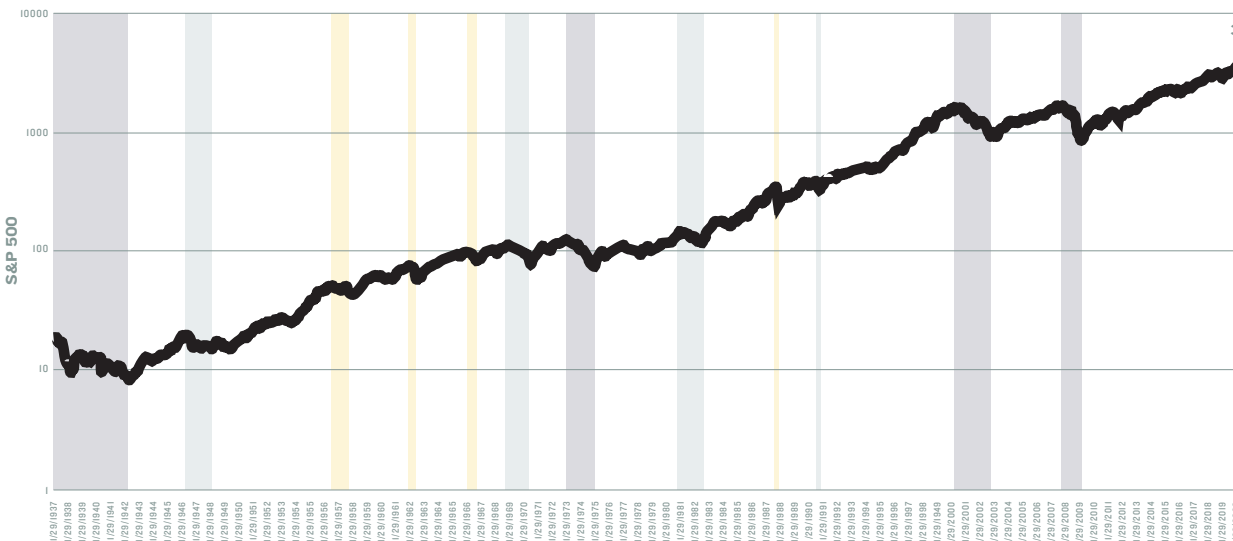


The big perspective tells us that markets are resilient and a bear market is never the end of the story.

But just as we take the wisdom of Warren Buffet as he speaks to the clarity of the rearview mirror, we should also consider the wisdom of Peter Lynch as he reminds us, “You can’t see the future through a rearview mirror.” The future is unknown, which explains the daily ups and downs of the market as people speculate on what tomorrow holds. No one is certain on whether our impending bear market will prove to remain event driven or lead into a cyclical or structural bear market, but a historical long ranging perspective reminds us to zoom out from our current situation and look at the big picture.

S&P 500 Return

- EVENT-DRIVEN
- CYCLICAL
- STRUCTURAL
- S&P 500 INDEX



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The *long-term perspective* radically changes one's view of the risk of stocks. The *short-term fluctuations* in market, which loom so large to investors, have little to do with the long-term accumulation of wealth.”

JEREMY SIEGEL

References

- ¹ <https://www.goldmansachs.com/insights/pages/briefly/bear-essentials.pdf>
- ² The S&P 500 or Standard & Poor's 500 Index is a market-capitalization-weighted index of the 500 largest U.S. publicly traded companies.
- ³ Source: Eventide Asset Management, Morningstar. Vertical Colored bars indicate the different classifications of bear markets and time periods based Goldman Sachs, "Bear Essentials: a guide to navigating a bear market" March 9, 2020. <https://www.goldmansachs.com/insights/pages/briefly/bear-essentials.pdf><https://www.goldmansachs.com/insights/pages/briefly/bear-essentials.pdf>.
- ⁴ Source: Eventide Asset Management, Morningstar. The average bear market decline of S&P 500 price index is calculated as the averaged decline from prior month price high for each bear market time period. Recovery time is recovery back to nominal S&P value. Bear market time periods and classifications are based on Goldman Sachs, "Bear Essentials: a guide to navigating a bear market" March 9, 2020. <https://www.goldmansachs.com/insights/pages/briefly/bear-essentials.pdf><https://www.goldmansachs.com/insights/pages/briefly/bear-essentials.pdf>. Recession time periods have been expanded to illustrate subsequent index price recovery.
- ⁵ We chose to use 1937 as a starting date to capture the first bear market following the Great Depression. The Great Depression introduces extreme outlier datapoints which we believe skew the average outcomes.

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