INVESTMENT FUNDAMENTALS

Corrections, Bears and Crashes

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Snapshot

- Corrections, bear markets and crashes are terms used to describe stock-price declines of varying severity.
- The most important thing an investor can do is avoid making emotionally-driven investment decisions when one of these declines occurs.
- Diversification may help mitigate risk and provide solace when the market inevitably heads south.

Stock-market declines can cause investors to panic and start wondering if they should make changes to their portfolios. No one likes seeing losses. But it's important to consider the severity of each market downturn—whether it's a correction, bear or crash—before deciding to alter a long-term investment strategy.

Corrections (least severe)

- Defined as a decline of 10% or more from the most recent high
- Occur about once per year in the U.S. and last about two to three months
- Serve to keep stocks from becoming overpriced or inflated—correcting market exuberance that may otherwise result in stock prices rising faster than is justified by underlying company earnings

Bear Markets (second most severe)

- Defined as a sustained decline (at least two months) of 20% or more from the most recent high
- Occur about once every three years in the U.S.
- The bear market sparked by the global financial crisis in 2007 disappeared two years later

Crashes (most severe)

- Defined as a sudden decline (such as within a single day or week) of 50% or more from the most recent high
- Occur far less frequently than corrections or bear markets
- Typically followed by recession (defined as two or more consecutive quarters of economic output falling by at least 10%) or depression (loosely defined as an even steeper, more prolonged decline in economic output)

Exhibit 1: Corrections, Bear Markets and Crashes of the S&P 500 Index*

Peak Date	Trough Date	Date Loss Was Recovered	Days from Trough to Recovery	% Loss
5/13/1965	6/28/1965	10/5/1965	99	-9.60%
2/9/1966	10/7/1966	5/5/1967	210	-22.18%
10/9/1967	3/5/1968	4/29/1968	55	-10.04%
11/29/1968	5/26/1970	3/6/1972	650	-36.06%
4/28/1971	8/9/1971	1/18/1972	162	-10.73%
9/8/1971	11/23/1971	12/20/1971	27	-11.03%
1/11/1973	10/3/1974	7/14/1980	2,111	-48.20%
11/7/1974	12/6/1974	1/27/1975	52	-13.56%
6/30/1975	8/21/1975	1/12/1976	144	-12.73%
9/21/1976	3/6/1978	9/12/1978	190	-19.41%
9/12/1978	11/14/1978	8/10/1979	269	-13.55%
10/5/1979	11/7/1979	1/18/1980	72	-10.25%
2/13/1980	3/27/1980	7/7/1980	102	-17.07%
11/28/1980	8/12/1982	11/3/1982	83	-27.11%
10/10/1983	7/24/1984	1/21/1985	181	-14.38%
8/25/1987	12/4/1987	7/26/1989	600	-33.51%
7/16/1990	10/11/1990	2/11/1991	123	-19.92%
2/18/1997	4/11/1997	5/5/1997	24	-9.63%
7/17/1998	8/31/1998	12/18/1998	109	-19.34%
4/7/2000	10/9/2002	9/18/2007	1,805	-48.77%
11/27/2002	3/11/2003	5/27/2003	77	-14.71%
10/9/2007	3/5/2009	3/28/2013	1,484	-56.39%
4/15/2010	7/2/2010	11/4/2010	125	-15.61%
4/29/2011	10/3/2011	2/24/2012	144	-19.39%
4/2/2012	6/1/2012	9/6/2012	97	-9.94%
5/21/2015	8/25/2015	7/11/2016	321	-12.35%
11/3/2015	2/11/2016	6/7/2016	117	-13.31%
1/26/2018	2/8/2018	7/26/2018	168	-10.20%
9/21/2018	12/31/2018	—	—	-14.50%

*Corrections = loss of 10% to 20%; bear market = 20%+ loss; crash = 50%+ loss
Source: Yardeni Research, St. Louis Fed - FRED

What to do?

Whether the market corrects, becomes a bear or suddenly crashes, we believe the most important thing an investor can do is avoid making investment decisions based on emotions.

This is particularly true when it comes to **stock-market corrections**. Despite the regularity of these less severe slumps, the S&P 500 Index (which is widely regarded as the best gauge of large-capitalization U.S. stocks) has gained an average of 10% over the last 50 years (according to Bloomberg, as of 12/31/2017)—signaling, in our view, chances of recovering correction-related investment losses relatively quickly. We therefore think it's best for long-term investors to wait when faced with these less significant downturns.

A similar logic applies to **bears and crashes**. The odds of realizing a loss actually increase when we purge stock investments in response to major stock-market downturns. Doing so also means potentially missing out on gains during an eventual recovery. We think a better approach is thinking of these low periods as opportunities to buy stock at a discount.

It's difficult to predict a market downturn, and it's even harder to forecast the severity or duration of a given slump. What investors can do is assess their portfolios in context of their long-term investment goals, being sure to diversify across a variety of asset classes, industries and countries. This can help to mitigate risk and provide some solace when things head south—as history shows they inevitably will do.