Few experiences worry investors more than the thought of losing money. We’re able to cope with small setbacks, but significant declines of 20% or more—referred to as “bear markets”—affect us differently. Seeing our portfolio drop precipitously in value evokes deep emotions, from the loss of independence and years of savings to the decimation of future goals and plans. Investors often go to extraordinary lengths to insulate themselves from and avoid what they perceive to be the harmful effects of bear markets. From talking with investors and clients over the years, I’ve found that our understanding of and expectations for bear markets are often misguided, causing unnecessary anxiety and counterproductive portfolio moves.

Given that it has been a few years since our last major decline, let’s explore the modern history of bear markets and the legends of the fall.

**Legend #1 — Bear markets happen all the time.**

Investors always think the next bear market is right around the corner, assuming that significant declines occur every year or two. Table 1 below looks at all losses of 20% or more on a global all-stock asset class index portfolio since 1970. There have been a total of six bear markets, or approximately one every eight years, with no discernible pattern. While we saw two bear markets in the 2000s, we’ve only experienced a single episode in the 1970s, 1980s, 1990s, and so far in the 2010s.

If you’re sitting around expecting the next big decline to happen soon, you are often waiting a very long time.

**Legend #2 — Bear markets last a long time.**

When investors imagine bear markets, they often think of multi-year stretches when stock prices grind perpetually lower. But Table 1 finds that most bear markets typically last a few quarters. Only two of the last six bear markets lasted longer than a year, and none lasted two years. The 2002 and 2011 bear markets didn’t even last two full quarters, and the 1987 bear market was over in three months.

If you’re not obsessively checking your portfolio balances, by the time you even notice a decline, it’s often close to being over. The less you look at your accounts, the better.

**Legend #3 — Bear markets always mean 40% to 50% losses.**

Most of us have lived through the 2002 and 2008 markets, and some older investors even have a memory of 1973-1974. In each period, the S&P 500 declined by at least 40%, including -51% from 2007 to 2009. But declines of that magnitude, at least for a global stock asset class portfolio, are the exception and not the norm.

* through September 2017 due to data availability
Table 1 on the previous page looks at the cumulative declines for a global stock asset class index over the last six bear markets. Only one—2007 to 2009—registered a loss of 40% or more. The 1973-1974 decline was -35.3%, and every other bear market was a more shallow -20% to -25% loss.

You need to be prepared for worst-case scenarios: a 2008-like decline. But also realize that not every moderate bear market will turn into a wipeout.

Some investors have a policy of selling out of stocks after a decline of about 20% to prevent further losses. But history shows that instead, they often wind up missing the early—and very profitable—stages of a recovery.

Legend #4 — Bear markets recoveries take a long time.

For many investors, it’s not just the fear of bear market losses that worry them. It’s also the concern that the decline will be so large that it will take many years—sometimes a decade or more—to recover. Retirees in particular often are concerned that they no longer have time to wait out the losses.

But Table 1 shows that recoveries tend to be swift and substantial. Five years after the onset of a bear market, the global stock asset class index was meaningfully higher (including the initial decline) in five of six episodes. In the one instance where it did not fully recover (after 2007-2009), it was within 3% of its previous high—basically breakeven.

Looking out 10 years, the global stock asset class index had more than doubled in five of the six periods, and more than tripled in value in three of them. The worst of the decade-long outcomes saw the global stock asset class index completely shed its bear market losses and end over 80% above its previous peak.

Each of these 10-year periods would be considered a good result in normal times. The fact that they began on the eve of a bear market makes the results even more impressive.

Legend #5 — Bear markets ruin retirements.

An entire cottage industry within financial services has sprouted up to help retirees cope with what we are all told is “sequence of returns risk,” or the notion that if you retire on the eve of a bear market, you’re toast. But like many other market legends, this one is toothless. There’s no doubt, a 20%, 30%, or 50% decline can take a big bite out of your retirement nest egg. But is it permanent?

Consider a hypothetical investor with $1M in a global stock asset class index portfolio whose goal is to spend $50,000 (5%) a year, adjusted for inflation, from their investments.

The chart below summarizes the first decade of results if they retired at the worst possible times: 1973 or 2008.

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Growth of $1,000,000, net of $50,000 in yearly withdrawals adjusted annually for inflation

<table>
<thead>
<tr>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
<th>Year 4</th>
<th>Year 5</th>
<th>Year 6</th>
<th>Year 7</th>
<th>Year 8</th>
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<td>$1,166,469</td>
</tr>
</tbody>
</table>

10 years later (thru 1982 and September of 2017), not only did the retiree not run out of money net of withdrawals, but in each case the portfolio was worth more than it started with a decade earlier and was trending even higher!

Lessons From The Legends of the Fall

History shows us that bear markets are an inevitable part of investing in stocks but they are not something to fear. It’s not necessary to anticipate when the next big market decline will happen and bail out before or during its early stages. Bear markets, while painful, are often over before you know it, and the magnitude of the decline is typically matched by the size and speed of the recovery.

What’s more, bear markets don’t have to permanently throw you off your accumulation or retirement course, contrary to what the legends say. As a saver, temporarily lower prices offer you an opportunity to invest more cheaply and accumulate greater future wealth. Once you shift into spending mode, the combination of a modest and disciplined spending rate (4% to 5% of your portfolio) as well as having a few years of income set aside in short-term bonds can insulate you from temporary market losses without permanently derailing your retirement.

Global Stock Asset Class Index = 21% DFA US Large Cap Index, 21% DFA US Large Value Index, 28% DFA US Small Value Index, 18% MSCI World ex-US Value Index (MSCI World ex-US Index prior to 1975), 12% DFA Int’l Small Cap Index, Rebalanced annually. Source: DFA Returns Web.

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