MarketWatch

The difference between a correction and a bear market — and other financial terms to know for 2019

Alessandra Malito January 1, 2019

© Getty Images Market volatility may have some investors confused — and concerned.

When there's talk of a market downturn, it's easy to panic about future investment returns and the potential to retire one day — but it's also imperative to know what's actually happening.

Investing is emotional, and many people tend to let their feelings get ahead of logic when ticker symbols are turning red and terms like "bear market" and "recession" are being thrown around.

"Sometimes I think people go more by how they feel than looking at the numbers," said Monica Dwyer, vice president and wealth adviser at Harvest Financial Advisors in West Chester, Ohio. "This is dangerous because emotions can lead to bad decisions."

First, it's important to define the meaning of the term "the market." Investors tend to look at two major indices — the Dow Jones Industrial Average or the S&P 500 — when referring to the stock market. Many experts believe a market downturn is looming, but that term often refers to U.S. equities, not necessarily bonds, international funds or commodities. Typically, investment portfolios are diversified among various asset classes (or at least, they should be), which means what is happening in the stock market isn't necessarily happening across your entire investment portfolio.

Here's something else investors should know about the investing terms they're hearing lately: descriptions like pullback, correction, and bear (or bull) market can be applied to specific stocks, assets and indexes. They can also be based on any time-frame — between a day and a decade — which could confuse investors trying to understand how this applies to their own investments.

Here's a breakdown of these terms:

Pullback: A pullback refers to a share price decline 5% and 9.9% from the price's peak, said Eric Walters, a financial adviser and president at SilverCrest Wealth Planning in Greenwood Village, Colo. There have been 78 market pullbacks since the end of 1945, according to asset management and investment firm Guggenheim Investments. Comparatively, there have been 27 corrections (with an average decline of 13%) and eight bear markets (with a 27% average decline).

Correction: A correction is a loss of 10% from a recent high. Pullbacks and corrections are more likely than full bear markets, said Abe Ringer, a financial adviser and founder of Breakwater Financial in Needham, Mass. "When we look at today's market, many are instantly assuming that we are going to get through another dot.com-era bear market, or a financial crisis-era bear market," he wrote. "When we look at all of the information, and not just the most recent, we know that declines of that magnitude are rare and not the norm."

Bear market: A bear market is a decline of 20% from a recent high. But investors still shouldn't panic when they hear the stock market is in a bear market, because most likely their portfolios aren't entirely invested in these equities, Walters said. There are different types of equities — including large cap, mid-cap and international — and they can each fluctuate in value differently. While some are plunging, others may actually be recovering from their lows. "It also doesn't mean there is a recession in the economy," he said.

The threat of a bear market is brought up a lot on Wall Street and in the media, said Ian Weinberg, chief executive officer of Family Wealth & Pension Management in Woodbury, N.Y. "When we saw the market go up and down 1,000 points the other day and we have a 5% swing, does that mean it's a bear market?" he said. "It's very open to interpretation and I think the term causes investors to behave badly."

Recession: Recession is a broader term that refers to the country's overall economic performance, not just investments. A recession can cause the stock market to fall, but the reverse can happen too, where a financial crisis can spark a recession. Real estate bubbles and the collapse of the subprime mortgage industry helped fuel the 2008 financial crisis, and some argue that the 2008 stock market crash exacerbated the Great Recession.

The country is in a recession when there are two consecutive quarters or more of negative growth in Gross Domestic Product growth — the total value of all goods and services produced in the country. Some economists believe the next recession will happen around 2020 (which would also mean the current expansion the U.S. is experiencing would be the longest recorded). For many Americans, the most worrisome part of a recession is the possibility of job loss — unemployment often increases during recessions as consumers slow their spending and companies cut costs.

Realized vs. recognized losses: There are a few other ways investors can gain perspective during market volatility, advisers said. Investors should understand the difference between “realized” and “recognized” losses. Realized losses means the amount of money a person actually lost, whereas recognized losses refer only what’s been lost on paper. For example, if an investor’s portfolio were to drop $1,000, but that investor didn’t sell his stocks, it is a recognized loss. If the investor were to pull his portfolio out of the market after experiencing that loss, it would be a realized loss.

Points vs. percentage drops: Market drops can sound dramatic, but pay attention to what’s being described. The media usually refer to market movements on a points-basis, such as an index dropping 1,000 points. That could sound like bad news for your portfolio, but investors should look at what those points mean in percentages, said Eric Freckman, managing partner of advisory firm Guillaume & Freckman in Palatine, Ill. When his clients ask him about these point fluctuations, he translates it into actual portfolio changes — a 500-point drop in the S&P 500, for example, might equate to just 0.7% drop in a client’s diversified portfolio. “We try to bring it back to reality,” he said.