Market Bears are Stirring After a Long Hibernation

Commentary

December 2018

- Most U.S. equity indexes are nearing the 20% decline level that technically marks a bear market.
- The yield on the 10-year U.S. Treasury bond is well below 3%, despite the Fed's effort to raise rates, as investors are flocking to safer assets.
- It's important to remember that while these market gyrations are painful they are also to be expected and SEI's long-term views take market downturns into account when constructing client portfolios.

Most major U.S. equity indexes are nearing, or are already in, bear market territory defined as a decline of at least 20% from their recent peaks. Many technology companies and small-cap stocks have seen even steeper drops. While these losses are significant, SEI's Chief Economist Jim Solloway notes that that fundamentals of the U.S. economy don't justify a recession. For long-term investors, we believe down markets present buying opportunities.

Bear Market Perspective

Stocks generally do not make gradual moves during bear markets. Instead, they spike higher and lower from day to day. Nowhere are those spikes more dramatic than when the market is reaching its extremes, or more specifically a bottom.

Over the last 50 years, the S&P 500 has experienced seven major bear market cycles, with price declines over 20%. The average bear market cycle during this period lasted about 17 months, with an average loss of 39% and average time to recovery of 33 months. Losses of this magnitude are without a doubt painful for any investor.

But for long-term investors it's important to remember that declines of this nature are factored in to SEI's long term view during portfolio construction – meaning these losses were already factored in to long-term client return assumptions. And while it's human nature to want to avoid losses, the reality is that it's extremely difficult to time markets, both to avoid losses and then to re-enter so one can reap the long-term potential gains in equities. SEI recently covered this topic in depth in the paper, "The U.S. Bull Market: Is it Time to Get Out?".

Equity Bears Bring out Bond Bulls

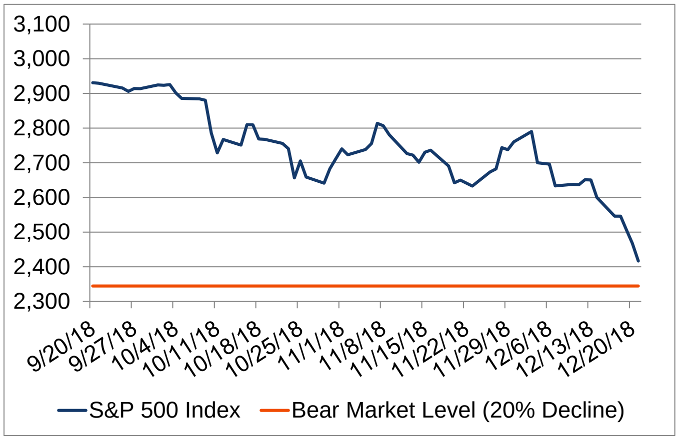
The U.S. Federal Reserve has been actively raising short-term interest rates while also reducing bond holdings on its balance sheet. Despite this activity, yields on the 10-year U.S. Treasury are at levels that were last seen in the first quarter of 2018. After reaching as high as 3.24% on 11/8/18, the yield for 10-year Treasurys plunged to 2.79% on 12/21/18, according to the U.S. Treasury Department (yields and prices move inversely).

For diversified investors it's important to remember that bonds are not just a source of income in a portfolio but they can serve as a ballast against stock market losses in times of turmoil for equities.

Stay Calm and Stay Invested

Now is not the time for investors to panic. If you're thinking about selling equities to avoid losses, it's already too late. Further if you do sell now, you'll eventually have to make a decision to buy back into equities. Our research shows the decision to get back in is just as difficult to make as the decision to get out, and investors are notoriously bad at both.

Exhibit 1: S&P 500 Index Performance



Source: SEI, S&P. 9/20/18 (most recent market peak) to 12/21/18.

Index Definitions

The S&P 500 Index is a capitalization-weighted index made up of 500 widely held large-cap U.S. stocks.

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