

The Anatomy of Major Bull and Bear Markets

Defining a bull or bear market isn't easy and it's certainly not clear-cut. Opinions differ on the way to measure the start and end of a market cycle and that leaves lots of room for creative interpretations about what's going on in the market at any given point in time.

I may not be the final authority on this, but I've been studying the market for more than 30 years, and I believe my approach to measuring these market cycles is practical and useful for teaching purposes.

The most commonly used definition of a bull or bear market is a move of 20% from high to low, or low to high. But how does one decide what the highs and lows are? Do you include dividends? Do you adjust for inflation?

Here is how I define bull and bear markets.

The "real" high is the inflation-adjusted high water mark, including dividends, at any point in the continuum of historical stock prices. The "real" low is the inflation-adjusted, dividends included, low water mark following the previous high water mark.

If this seems like nit-picking, let me explain why I think it's important for investors to understand these nuances in defining bull and bear markets.

The first point is whether or not to include dividends, which account for the difference between "price only" returns and "total" returns. I choose to include dividends because dividends have a significant impact on the total returns that are captured by investors. Excluding dividends would be like excluding the interest payments on bonds and only measuring bond market returns on the basis of the change in their prices.

The second point is whether or not to adjust prices for inflation. I choose to adjust for inflation because the purpose of investing is to increase purchasing power. It does no good for an investor to double her account value in an inflationary period, if her purchasing power doesn't increase concurrently.

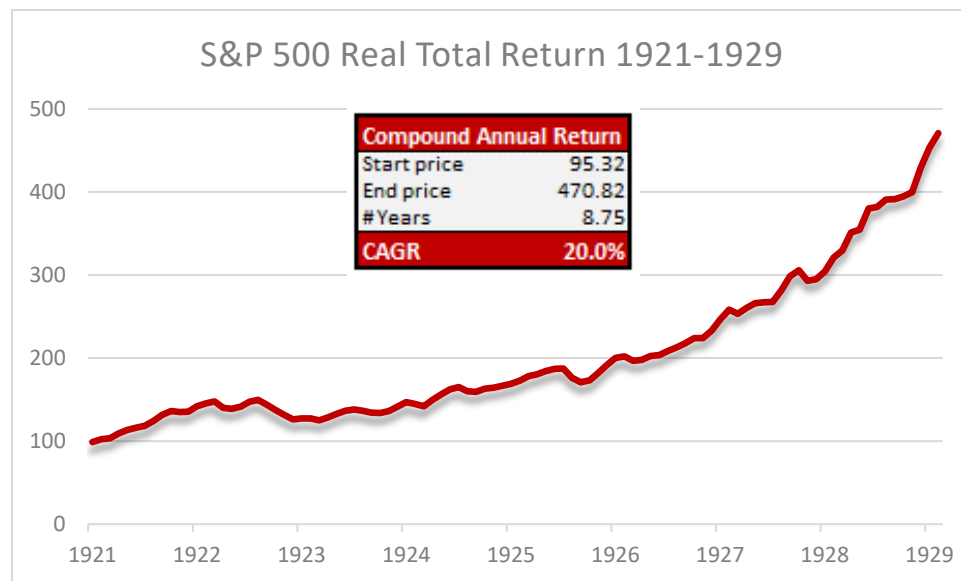
The third point is how to deal with 20% market moves that don't create new highs or lows. This happens frequently in the market. For example, after the market crash of 1929, there was a sharp rally beginning in 1932 and lasting until 1937. The market tripled in value over this five year period. It's hard not to call this a raging bull market.

But when this rally topped out, it was very far away from the old high reached in 1929. This is an extreme example, and many market historians consider the 1932-1937 period to be one of the best bull markets of all time.

I understand that, and I respect it. But I disagree on the basis of my real total return method of measuring bull and bear markets. Nevertheless, I will include the 1932-1937 market period as a bull market with the caveat that it would take many more years for the market to regain its 1929 high water mark.

With these definitions out of the way, let's proceed with the task at hand, which is to observe each significant bull and bear market, in order to put some context to what we are witnessing in the market today.

THE BULL MARKET OF 1921-1929: THE ROARING 20s



1921 was a great year to begin investing in the stock market. World War I had ended, and the soldiers who were fortunate enough to come home in one piece would go on to build the foundation of the Industrial Revolution.

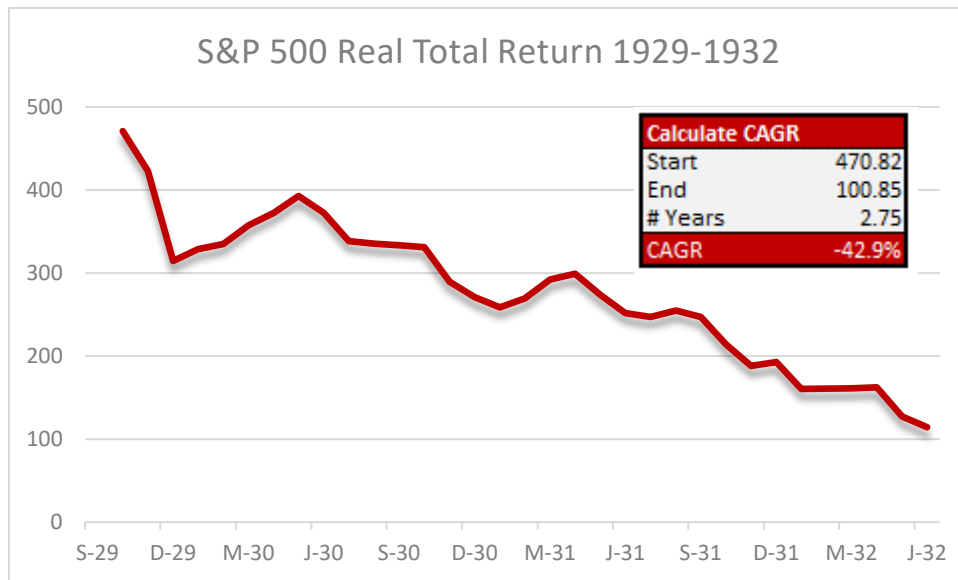
During the war, stocks had been reduced to prices that were beyond cheap. Anyone who had cash to invest in 1921 would be hitching their wagon to one of the greatest bull runs in history.

When this magnificent bull market finally topped out in September 1929, it had risen almost 5-fold and stocks were trading at a 100% premium to their fair value. For eight glorious years, the market went up an average of 20% per year.

Picking stocks in this bull market was like shooting fish in a barrel. Everything went up, or so it seemed. Cab drivers, bartenders, and shoe-shine boys all had hot stock tips for their customers. Everybody was making money... until the bill finally came due in September of 1929.

But few investors recognized the scope and scale of the stock market bubble as it was inflating. Lurking just ahead was the worst bear market in history. The Crash of 1929 wiped out 90% of the value of the market and led to the Great Depression. It would take 29 years for the market to reclaim its inflation-adjusted high water mark reached in 1929.

THE MARKET CRASH OF 1929

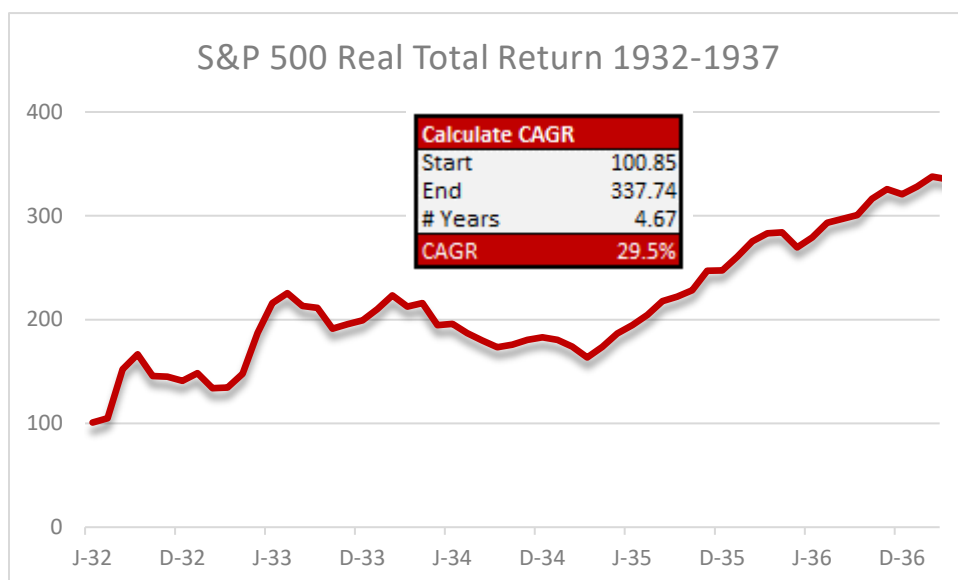


When the Roaring Twenties were winding down, the stock market had finally reached its peak. In September 1929 the market began the worst slide in its history, not stopping until it was down fully 79% from the top.

The decline was relentless. Wave after wave of selling overwhelmed all attempts to stop the carnage. By mid-1930, investors realized that the game was over. From that point forward, it was a seller's market and buyers who dared to venture into the bloodbath that was unfolding were quickly dispatched to the bread lines and soup kitchens that had sprung up around Wall Street.

The crash of 1929 was so bad, it motivated some Wall Streeters to jump out of windows to find relief from the financial pain they were suffering. Never in history, before or since, have we seen such drastic steps taken by investors who had suffered losses so devastating that they chose to end their lives.

THE BULL MARKET OF 1932-1937



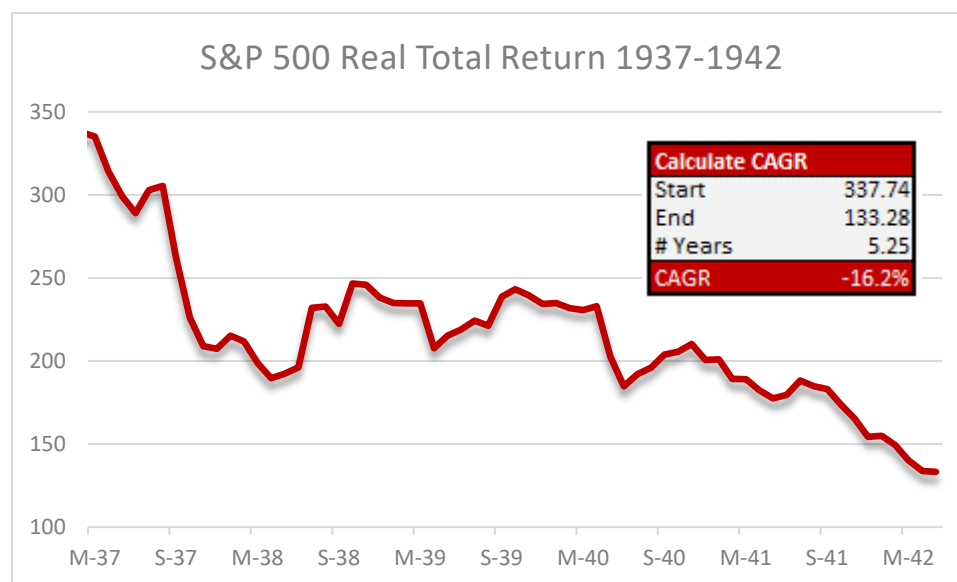
There are a few notable ways that the bull market of 1932 stands out from other major bull markets. For one thing, it was the pace at which stocks moved from undervalued to overvalued. Stocks were dirt cheap in 1932. This dramatic undervaluation was the spark for one of the most explosive rallies in stock market history.

In the summer of 1932, investors had lost all confidence in the stock market. Many were completely wiped out, and most had lost half or more of their money. By 1932 there were hardly any sellers left to push prices any lower. This lack of sellers created an opportunity for those who were fortunate enough to still have money, to begin picking through the rubble to find bargains.

For the next 5 years the bargain hunting buyers ruled the market. There was virtually nobody left to sell, and so prices had nowhere to go but up. And up they went. By the time this rally topped out in 1937, new fortunes had been made and a new class of fat cats was born.

And then the music stopped. What came next was a second leg down in the Great Crash of 1929.

THE “MAKE THE RUBBLE SHAKE” BEAR MARKET OF 1937

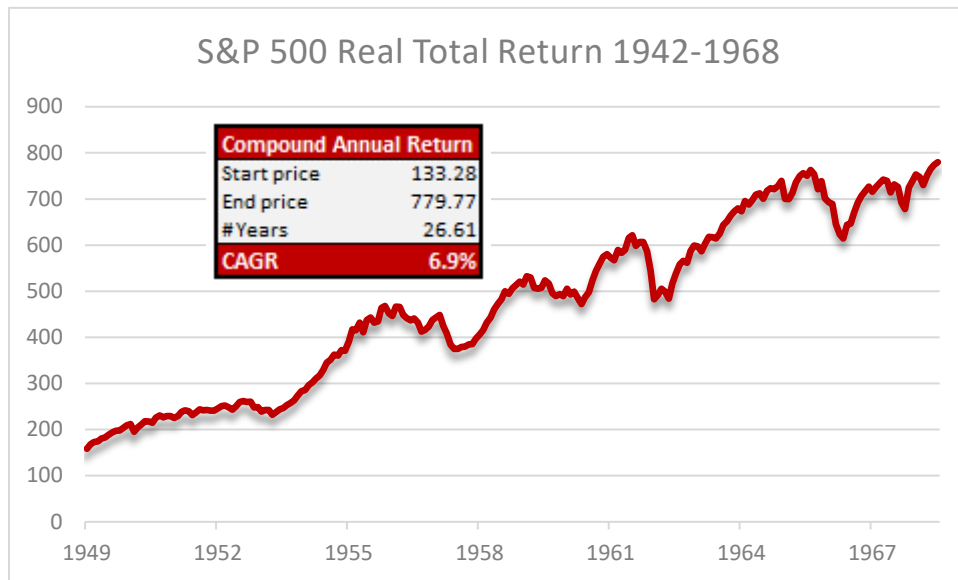


The bear market rally of 1932-1937 ended with a bang. The newly designated market mavens who had taken advantage of bargain-basement prices in 1932 were now faced with a difficult decision. Should they hang on to their fat profits, or jump ship?

Most chose to ride out what they believed to be just a temporary interruption in the grand rally that had increased their wealth considerably. But they were wrong to do so. By the time this leg down was over, the bargain-hunters of 1932 had lost everything they gained, and then some.

At this point, we had two generations of investors who fled the market for good. The first was the Roaring Twenties crowd, and now we had the newly wealthy speculators who were forced to join the rest of the crowds lining up for bread and soup and hoping for government jobs to salvage what they had left of a nest egg.

THE WORLD WAR II HAPPY DAYS ARE HERE AGAIN RALLY



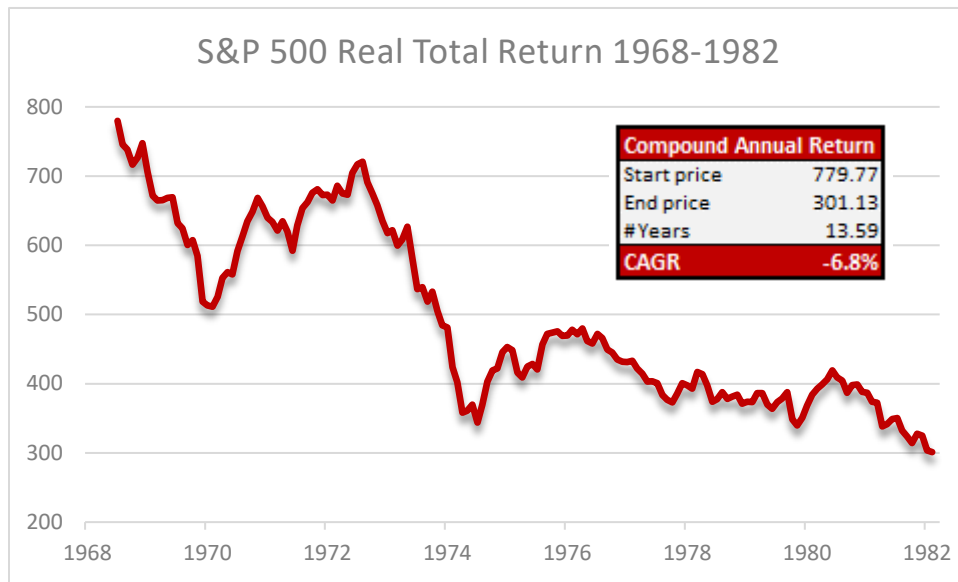
Just when everyone thought that things couldn't possibly get any worse... they did. December 7, 1941 – a day that will live in infamy – marked the beginning of World War II and the start of the longest bull market in history.

It's a sad fact of life, but war is good for the economy. Well, at least it was in 1942. As the U.S. manufacturing industry geared up for war, production skyrocketed, and a nation pinned its hopes and aspirations on Franklin Delano Roosevelt.

The war effort created a boom in manufacturing and the economy began to lift out of the depths of the Great Depression. When the war ended, Roosevelt enacted what he called the New Deal, which promised to put a chicken in every pot and a car in every driveway. His vision was bold, and it worked. He created jobs programs, a social safety net, and strict banking regulations that helped put the U.S. economy on firmer footing for the next 24 years.

Happy days were indeed here again, and people returned to the stock market in droves. The rally of 1942 did not stop until 24 years later in 1968.

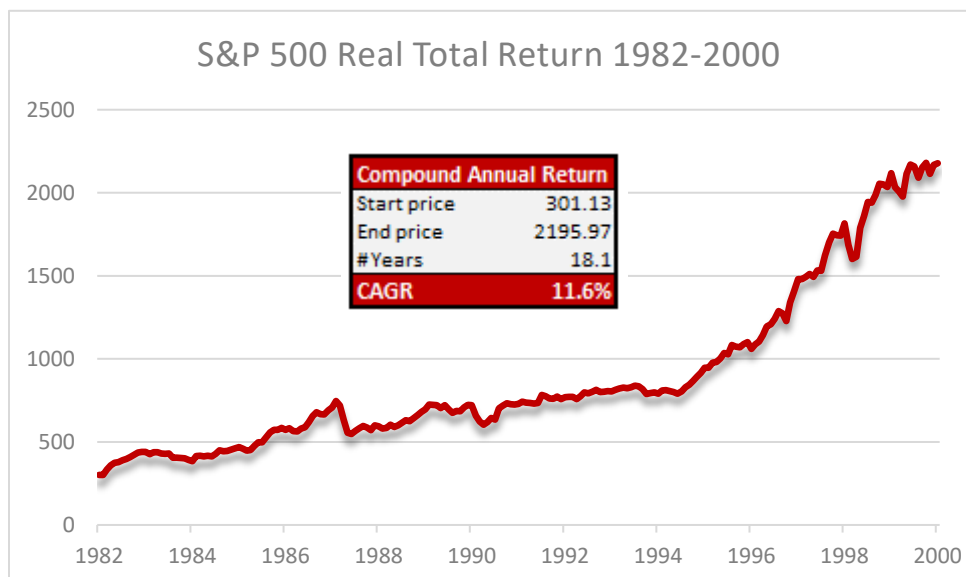
THE SOCIAL UNREST AND OIL EMBARGO MARKET



By the time the rally of the '40s and 50's came to an end, the country was divided about where we should be headed in the future. Students began protesting the war in Vietnam, and the Summer of Love turned into the winter of hate as the younger generation battled with the establishment for control of policy.

Watergate cast a pall over the landscape, and shortly thereafter the Oil Embargo created gas lines and accelerating inflation. The economy was struggling, and the stock market reflected it. It wasn't until 1982 that people began to settle down, and a new age began to emerge.

THE GORDON GEKKO GREED IS GOOD MARKET

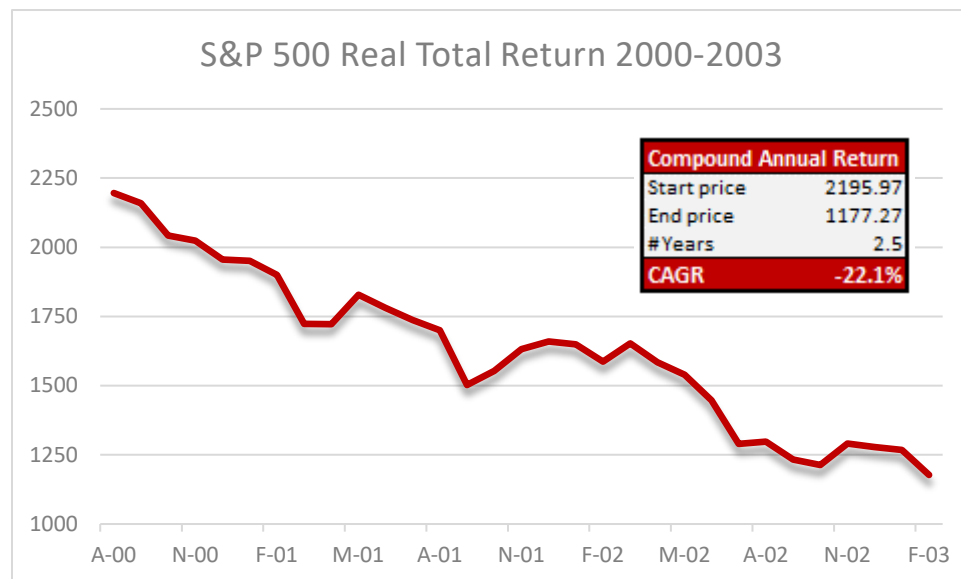


“Greed, for lack of a better word, is good. Greed is right. Greed works. Greed captures the essence of the evolutionary spirit.” So said Gordon Gekko, of Wall Street fame, played by Michael Douglas.

And for the period of 1982-2000 he was right. Greed worked. But market history tells us that all periods of excessive greed end badly, and this period was no different. By the time the Gekko market peaked in 2000, investors were paying exorbitant prices for tech startups that had no earnings, no sales, and nothing to offer but the promise of “clicks” or “eyeballs.” That’s what investors craved, and that’s why the 2000 tech bubble happened.

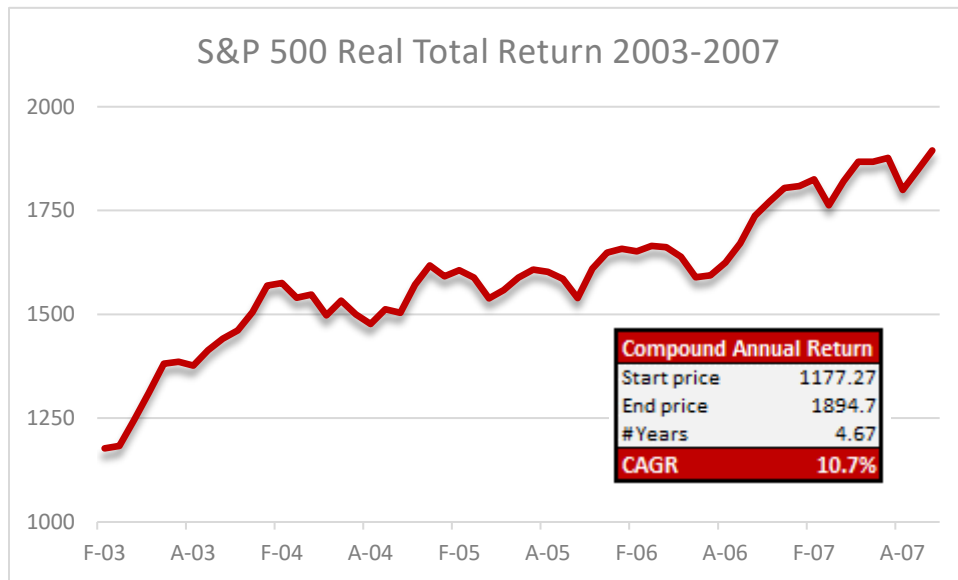
Then came one of the saddest periods in the history of America. Fallout from the tech bubble bursting created a recession in late 2000. Shortly after that, 9/11 happened. The market was closed for several days, and when it reopened it crashed, as most investors knew it would. It would take until 2003 for the market to claw its way back to pre-9/11 levels.

THE BURSTING OF THE TECH BUBBLE



The period of 2000-2003 was very dark. The bursting of the tech bubble; Enron; Worldcom; 9/11; the list goes on. Once again, investors fled the stock market in droves. An entire generation of investors would not return until 2010.

THE HOUSING AND MORTGAGE BUBBLE

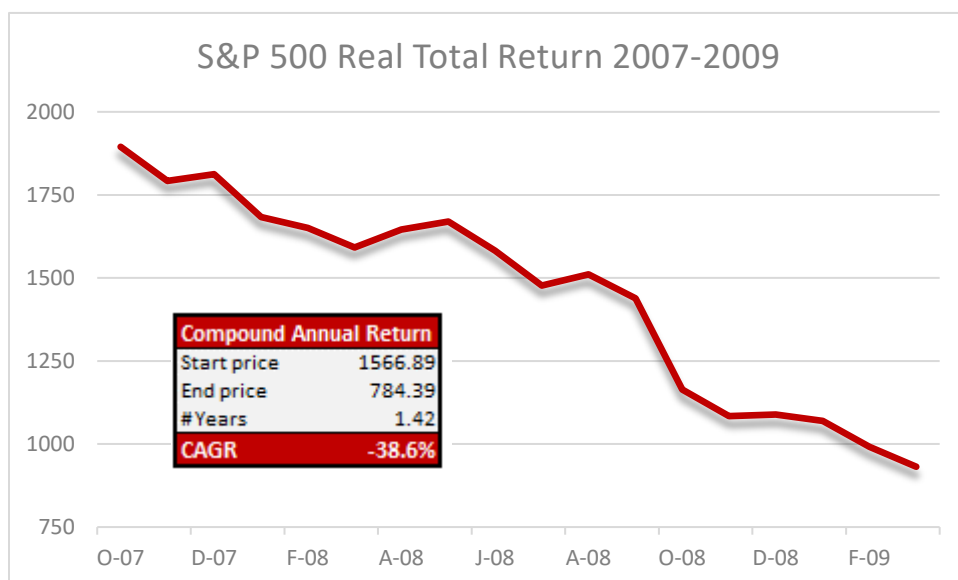


In the aftermath of the tech wreck of 2000, the Federal Reserve decided that the best way out of that crisis was to lower interest rates to 1% and keep them there as long as it might take. Bond investors around the globe who depended on much higher rates, began scouring the world for securities that would offer more than 1%.

Wall Street stepped happily into the breach and created a class of new securities that were based on home mortgages. So intense was the demand for these securities that mortgage bankers began to invent higher and higher risk mortgages. No income? No problem. Just sign here and we'll give you a \$200k loan to buy that \$1 million dollar house.

In hindsight, of course, it was all a house of cards that could not possibly be sustained. When the dam broke with the fall of Lehman Brothers, the global economy nearly collapsed.

THE GLOBAL FINANCIAL CRISIS OF 2008

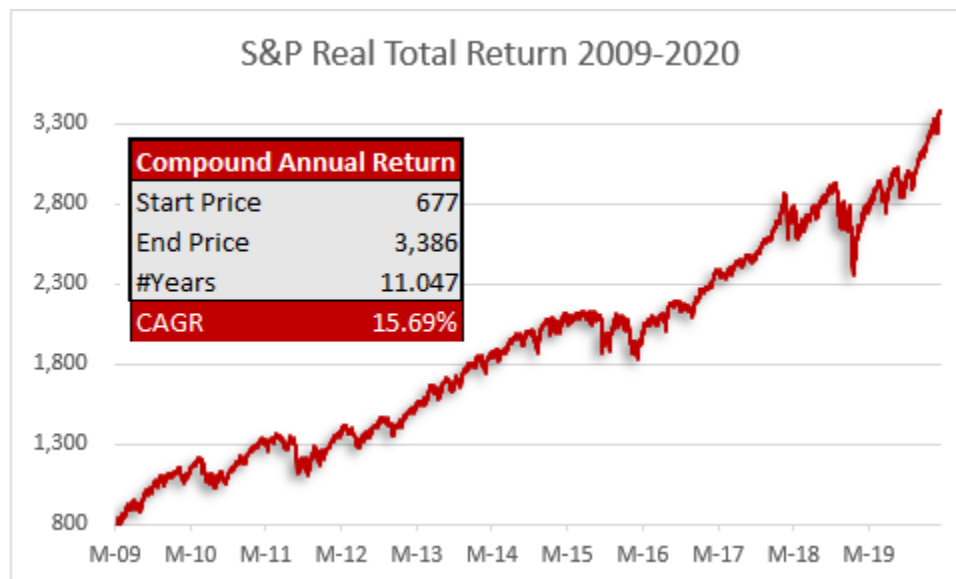


The first domino to fall was the market for sub-prime mortgages. Next was a couple of mortgage funds managed by Bear Stearns. Soon after was the bankruptcy of a few high-profile European lenders who had stuffed their balance sheets with too much of these toxic mortgage securities.

Then the other shoe dropped. After bailing out several banks and brokerages, the Fed decided to draw a line in the sand and not bail out the troubled Lehman Brothers, a 100 year old investment bank that had embraced the mortgage security market.

Panic ensued, and by the time the smoke cleared, investors had lost half of their nest eggs, and the global economy was teetering on the brink of a total collapse.

THE GREAT BULL MARKET OF 2009-2020



Realizing their mistake by allowing Lehman Brothers to go bankrupt, the Fed, Treasury, and Other major banks pulled together a rescue plan that included cutting interest rates to nearly zero and holding them there for an extended period of time. This flurry of actions restored faith in the global economy, and the US stock market was off to the races.

I must admit that I was a bit flummoxed at first by the speed of the recovery from the Global Financial Crisis and the great bull market that came with it. Some market historians claim that this entire rally has been fueled by cheap money and tons of liquidity courtesy of the Federal Reserve. That might be the most salient explanation, but it's certainly not the only one.

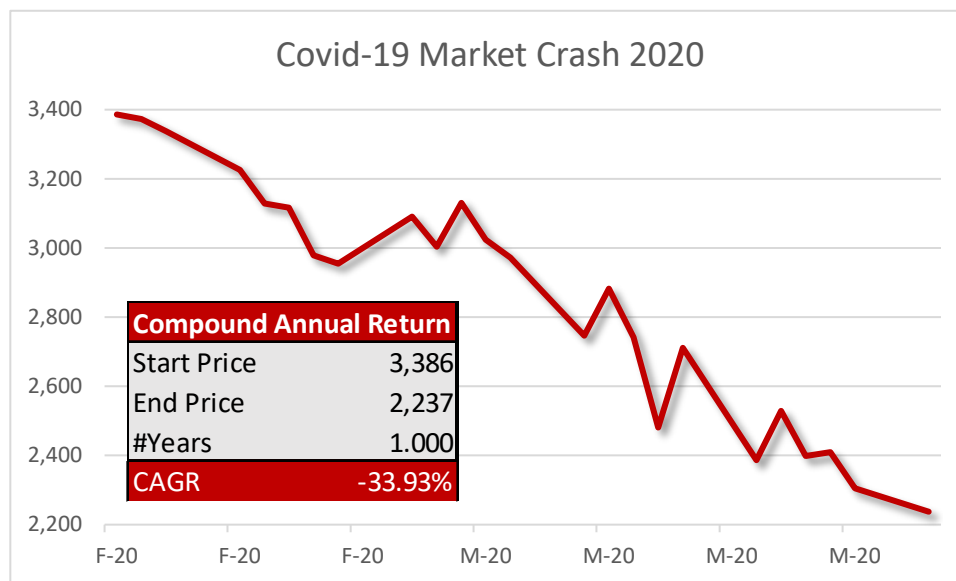
At the low point of the Great Financial Crisis, banks were throwing everything but the kitchen sink into their financial statements, and as a result, bank earnings were negative on the whole. That contributed to the final bottom in March 2009.

But closer to the truth was the fact that the Fed was backstopping the banks by taking their toxic mortgage securities off their hands and parking them on the Fed's own balance sheet. The question is, to whom will the Fed sell these toxic securities?

Many of these securities have recovered, at least partially, from their crisis-lows. However, have you looked at the balance sheet of the Fed lately? They are leveraged to the hilt, and they are now trying to unload merchandise while raising interest rates at the same time. It's a mess, to put it in technical terms.

Furthermore, Donald Trump is jawboning the Fed to lower rates. Will Chairman Powell cave into the president's demands? The balance sheet is a mess, and it will take heavy lifting by an independent Fed to correct the situation.

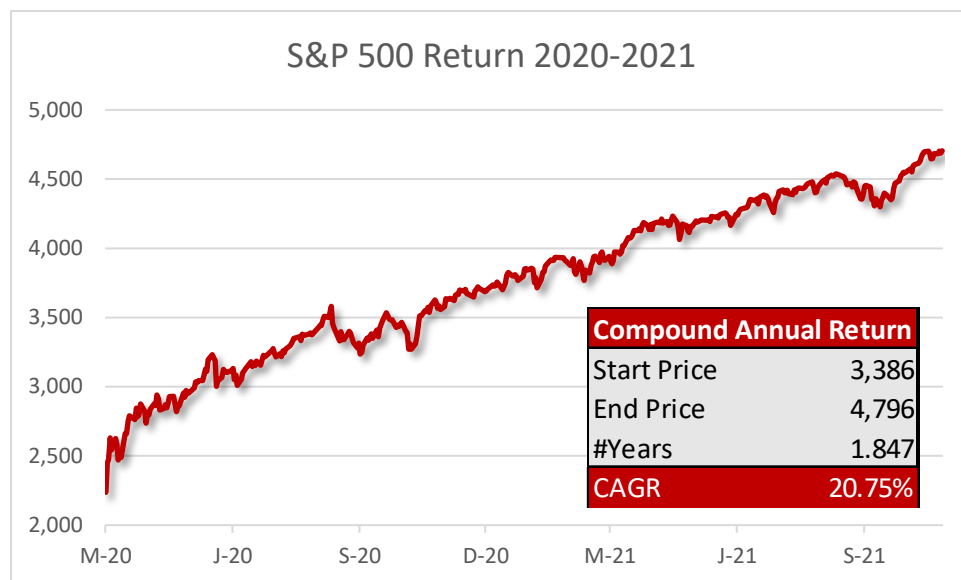
THE COVID-19 BEAR MARKET OF 2020



The Covid-19 market crash was the shortest bear market in recorded history. Investors quickly figured out that the shutdown of much of the economy would be temporary, until an effective vaccine could be developed to stop the spread of the virus.

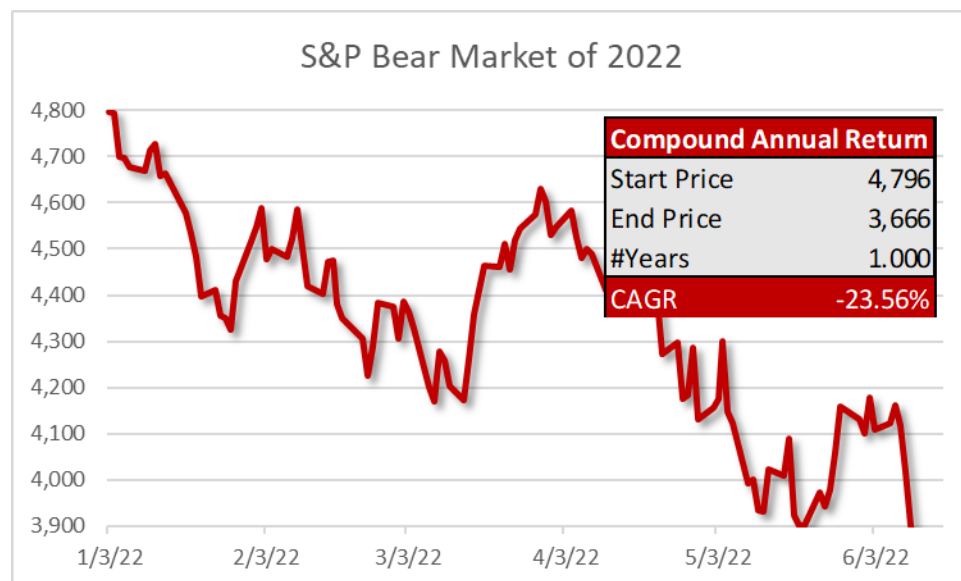
Investors who panicked and sold out during the selloff made a miscalculation that cost them dearly. Those who stayed fully invested were made whole by August of 2020.

THE BULL MARKET OF 2020-2021



The recovery rally and bull market post-Covid was strong, but short lived. It was interrupted by a bear market in 2022, which we will show next.

THE BEAR MARKET OF 2022



The bear market of 2022 was a brief one, lasting just 6 months. What came next was the beginning of the current bull market which is still alive as I write this.

FINAL THOUGHTS

There are about 100 million investors in the U.S. whose life savings could be severely damaged by the next bear market. And the chance of another bear market happening at some point in the future is 100%.

In his widely acclaimed book, “Stocks for the Long Run” Professor Jeremy Siegel says that since 1802 all an investor needed to do is stay fully invested in stocks for 17 years and they would never lose money. Taking inflation into account, your purchasing power would be left intact.

But few investors have the stomach to endure 17 years of being under water. Most investors today have a holding period of about 12 months. The average investor will likely encounter a bear market every 7 years or so, and every 10 years the bear market will be prolonged, pervasive and pernicious.

Siegel’s argument goes like this: Since we know from history that economic recessions and bear markets are a part of the landscape, and because nobody can predict when the next recession or bear market will arrive, the best strategy is to ignore bear markets, stay fully invested at all times, and in the long run you will make money.

Here’s the problem. Professor Siegel is an academic. His views come from an academic perspective. But most investors are not academics. Most investors don’t have the time or inclination to study the stock market like Siegel does. They go with their gut instincts and common sense. The idea that an investor would sit back and watch his or her life savings decline by 30-40-50% or more, and do nothing, is preposterous.

Therefore, I set about devising ways to reduce the amount of harm done from bear markets. I’ve been studying this for more than 30 years, and I have a strong belief that investors should find ways to protect their life savings from the ravages of recessions and bear markets.

A TALE OF TWO TRIBES

There are two tribes in the investor population – the “Efficient Market” tribe and the “Alpha-Seeking” tribe. The efficient market tribe believes that stock prices reflect all pertinent information about a company and therefore the current price is the “fair” price.

The Alpha-Seekers believe something very different. They agree that stock prices reflect all pertinent information about a company, but they also believe that stock prices reflect the aggregate emotions of investors. These emotions, at a basic level, include things like fear and greed.

Is one of these tribes right and the other one wrong? No. In fact, that’s the wrong question. The better question is this – are you better suited to be in the efficient market tribe, or the Alpha-seeking tribe? How you answer this question will have a dramatic impact on your investment performance.

Where most investors get into trouble is when they bounce back and forth between these two tribal belief systems, never staying long enough in either one to gain traction over the long term. The efficient

market tribe does better when the market is going up, but they get killed when it goes down. The opposite is true for the Alpha-seekers.

In a bull market, everyone looks like a genius. It's hard not to make money in a bull market. This is the kind of environment where the efficient market tribe shines. They don't have to do anything except sit back and watch their portfolio value go up and up and up. Until the market stops going up.

In a bear market, people get hurt. The efficient market tribe has a rule that mandates staying fully invested at all times, regardless of market conditions. In a bear market, they pay a heavy price for adhering to this rule. And that's why many of them abandon their strategy and sell their holdings, usually near the bottom of the market decline.

The Alpha-seekers have no obligation to stay fully invested. They are attuned to the changing conditions in the market and the economy, and they have contingency plans in place for dealing with adversity. As the market declines, they adjust their exposure to risk accordingly. And when the decline comes to an end, they are sitting on a pile of cash that they can use to pick up great companies at fire sale prices.

HOW I LEARNED TO STOP WORRYING AND HUG THE BEAR

Bear markets bring lower prices, and that's a good thing. Avoiding bear markets preserves wealth but buying great companies when they are on sale during a bear market is the best way to make serious money.

When stocks fall by...	Market pundits call it a...	It feels like...
5%	Dip	A mosquito bite
10%	Correction	A bee sting
20%	Bear Market	A punch to the gut
50%	Crash	A heart attack
80%	Depression	Dante's Inferno

- Since the end of World War II (1945), there have been 30 corrections of 10% or more, versus only 14 full-blown bear markets (with losses of 20% +).
- This equates to one correction roughly every 20 months. This average does not mean they're evenly spaced out. 25% of these corrections over the last 66 years occurred during the 1970's, another 20% occurred during the secular bear market of 2000-2009.
- The average decline during these 30 episodes has been 13.3% and they've taken an average of 71 days to play out (just over three months).
- From the beginning of the last secular bull market in 1982 through the 1987 crash, there was just one correction of 10% or more. Between the Crash of 1987 and the secular bull market's peak in March 2000, there were just two corrections. This means that secular bull markets can run for a long time without a serious pullback.
- Since the stock market's bottom in March of 2009, there have been only 6 corrections: In the spring of 2010 the S&P 500 began a 69-day drop of roughly 16%. The widely referenced summer

correction of 2011 lasted for about 154 days and almost became a bear market. The correction during the spring of 2012 set up one of the greatest rallies of all time, although it was barely a real correction, sporting a peak-to-trough drop of just 9.9% in just under 60 days. And the most recent slide of 12% happened in August of 2015.

- Bull market rallies in between corrections – and there have been 58 in the post-war period – tend to run for an average of 221 trading days before being interrupted and gaining an average of 32%.
- As to what we should do during corrections, I'd recommend maintaining a list of high-quality stocks you've been kicking yourself for missing out on and clearing the decks of any longs you don't truly love. For those with time horizons longer than five years (most), the best thing to do is grit one's teeth and do very little. If a correction of between 10 and 20% is unbearable to you mentally or financially, that means you probably have more money than you should invested in stocks or you're not as courageous as you thought you were when you set up your plan. Make the adjustment you can live with and remember this feeling the next time you find yourself chasing the market.
- As to the question of whether a correction could become a bear market (or worse even, *a crash*), the answer is that this is always possible. But most corrections do not become crashes, and *every single one of them* turned out to have been great buying opportunities in the fullness of time.

Source: <http://thereformedbroker.com/2014/02/03/a-field-guide-to-stock-market-corrections-2/>