Five past bear markets and what they taught us

As the coronavirus health crisis causes markets to plunge across the globe, we are once again in a bear market, or a market that has fallen at least 20% since its peak. We take a look at five bear markets from the past five decades and see what the lessons can be learned for today’s investors.

1. The Global Financial Crisis

In many ways the world is still recovering from the impact of the 2008 global financial crisis and the policy decisions resulting from it. The biggest crisis since the Great Depression, its roots lay in a US debt-fueled home purchase binge, which led to a spike in house prices.

At the same time, US lenders relaxed their lending standards, approving mortgages without requiring proof of assets or income. A critical flaw in the thinking behind these loans – and the complex securities1 related to them – was the assumption that house prices would not fall.

The financial system started to crumble under the weight of these low-quality loans and many flagship financial services companies went bankrupt, or were sold at distressed prices. The bear market that resulted lasted 17 months, with the S&P 500 Index losing more than half its value in dollar terms.

Extraordinary monetary policies were adopted by the US Federal Reserve (Fed) and other central banks to save the financial system. This set a precedent for the aggressive policy actions taken during the European debt crisis and the current crisis.

Unfortunately, there is no warning as to when a bubble will burst. Investors can only try to understand when markets appear extended, question all assumptions underpinning market conditions, and adjust for risk appropriately.

1. Security: a tradable financial asset such as a share in a company or a fixed income security also known as a bond.
2. The Dot-Com Crash

Exuberant investment in technology companies, often with scant regard to the solidity of their business models, led to a tech bubble in the late 1990s. An unpreceded number of private companies offered shares to investors to raise capital during 1999 and 2000, and the market became increasingly speculative. Companies found raising capital easy with accommodating capital markets, which led to surging stock prices. This was also the era of some major financial accounting scandals, notably World Com and Enron.

The market was already struggling to shake off the excess from prior years when the 11 September 2001 terrorist attacks occurred. This helped push the economy into a recession—a 30-month bear market, during which the S&P 500 Index lost just under half its value.

The signs, however, had been there for those who cared to look for them. Stock prices were rising way ahead of earnings, and many companies had dubious business models. By sticking to fundamentals, modeling a company’s business growth, understanding its product set, intellectual property or business model investors can properly assess a company’s prospect for growth.
3. The Gulf War

The US economy had already been weak as a result of tighter monetary policy when the Gulf War began in August 1990, leading to an accelerating decline in stocks.

The war caused oil prices to spike to their highest levels in a decade and a recession followed in the US. The downturn, however, ended up almost as short-lived as the war itself, with the market bottoming in October 1990 and making new highs by February 1991.

Conflicts and other unpredictable and disruptive global events will always be part of the investment landscape. Skittishness during increased market volatility can lead to questionable decisions. Investors should remain focused and look past short-term noise for long-term opportunities.

2. Monetary policy: a central bank’s regulation of money in circulation and interest rates.

(Source: Bloomberg, March 2020) Charts are provided for illustrative purposes and are not indicative of the past or future performance of any product.
**4. Black Monday**

The 1987 bear market was one of the first to highlight the potential impact of computer models used to guide hedging and trading strategies. There is continuing debate about whether these quantitative strategies, known as ‘portfolio insurance’, both contributed to the rise in valuations and exacerbated volatility.

An already volatile market was further rattled when Iran fired missiles at oil tankers and the US responded by destroying Iranian oil platforms. This ultimately sparked the ‘Black Monday’ market crash of 19 October 1987 when the S&P 500 Index declined by more than 20% in a single day.

The bottom of this bear market came just six and a half weeks after it began and the recovery was swift and stable. Those who sold in panic and left the market missed out on a significant rally later on compared to those who invested or rebalanced towards equities and boosted their returns. It serves as another reminder of the need for investors to keep a steady head during inevitable periods of geopolitical turbulence.

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4. Equities: shares issued by a company, representing an ownership interest.
5. Extreme Monetary Policy

After a decade of sustained inflation, in early 1980 the Fed raised interest rates to nearly 20%, pushing the US economy into a recession.

Inflation, which had been elevated ever since the 1973 oil shock, had risen to an astounding 13.5% by 1980. The Fed increased interest rates aggressively over the course of six months, with the Fed funds rate eventually reaching 17.6% in April of that year. The market finally bottomed in August 1982 after steadily declining for approximately two years. But by November 1982, just three months after bottoming, the market reached new highs.

6. And what now?

So much for five previous bear markets. Today, with the spread of Covid-19, we face equal or greater challenges. Stock markets have already seen the biggest selloff in a generation. Even gold – that ultimate ‘go-to’ asset for investors in troubled times – suffered in the face of a dramatic ‘dash for cash’ over recent weeks.

Since then central banks and policymakers have stepped in with a coordinated and unprecedented response. Among many actions they have taken is the lowering of interest rates – in some cases to levels never seen before. And, for now, volatility appears to have calmed slightly. But, as Covid-19 continues to spread around the world – and as the resulting economic lockdown gathers pace – where we go from here remains an open question.

One thing previous bear markets have taught us, however, is that life goes on. In each of these five bear markets, sell-off was ultimately followed by recovery. As ever, a small dose of historical context goes a long way to informing our current predicament.
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