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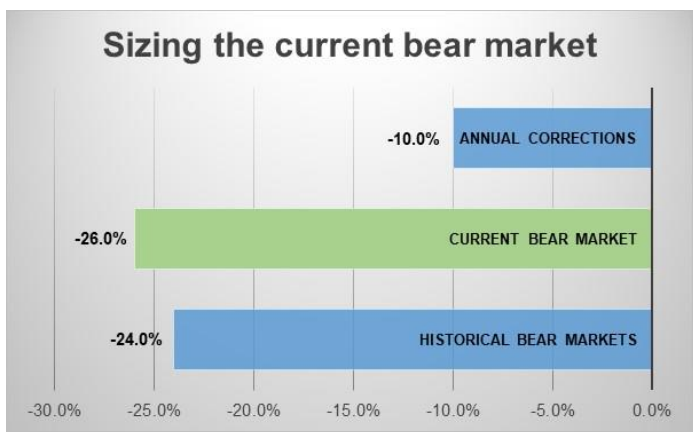
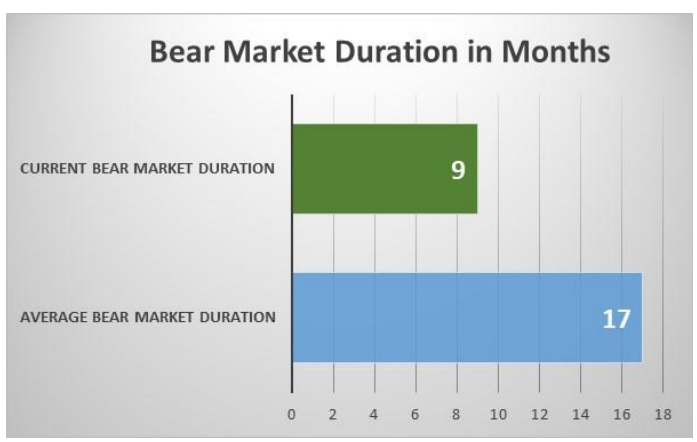
September 2022 Crescent Commentary

During September, U.S. stocks re-established a bear market after exiting bear market territory from June to September. The term “bear market” is a completely arbitrary term that means the stock market has fallen 20% or more from its highest level ever. Given that we have been involved in a bear market for nine months now, we want to provide you with a bear market survival guide. We’ll go over the historical percent decline of a bear market, how often bear markets happen, and how long the recovery typically takes. We’ll then explain what you should and shouldn’t do with your wealth in order to come out of the recovery in a position of financial strength.[1]

First, how does the current bear market compare to historical bear markets in the size and duration of its decline?



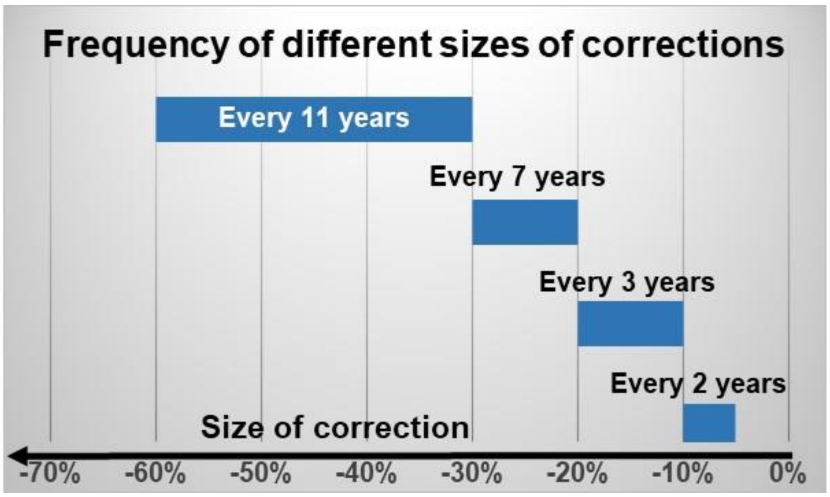


Source: The Wall Street Journal and First Trust

As you can see, the current bear market has reached a decline of 26% so far, which is less than the covid crash of 35% that we experienced two years ago, but a bit worse than the median historical bear market decline of 24%.(1)

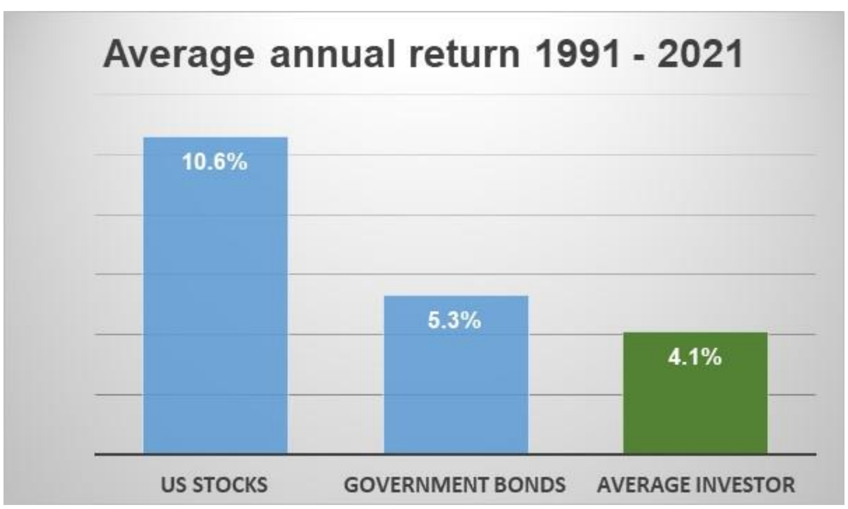
How long will the current bear market last? We wish we knew the answer, but nobody knows. The average bear market has historically lasted 17 months. The current bear market has gone on for 9 months. The best we can do at this point is look at proportions. With a current 26% decline compared to the 24% historical decline, we would guess that we're a little over halfway through the 17 months average if the current market decline remains near 26%. If the current bear market falls further, we would guess that it will last longer than the historical average of 17 months.(2)

How often do bear markets occur? Here's a chart showing the frequency of stock market corrections broken down by the size of the correction. As you can see, bear markets of the current size (26% decline) happen every 7 years. Bear markets of the size of the 2020 covid crash of 35% happen every 11 years. That's good news! We don't want them to happen often, obviously. And they don't.(3)



Source: Invesco

So, there's some information for you on how the current bear market compares to historical bear markets. When bear markets occur, a lot of investors want to know how long they will last or how far the market will fall. The problem is that no one can know that, and trying to guess will only hurt you. Rather than trying to know the unknowable, we recommend that investors focus on controlling what they can control – their decision making. What decisions should investors make during bear markets in order to find themselves in a position of strength when the recovery occurs? Do not sell your stocks. Here's a chart that shows the historical return on stocks and bonds, versus the return that individual investors as a whole actually earned:



Source: Invesco

As the chart shows, the average individual investor in stocks and bonds has gotten an annual return lower than both stocks and bonds over the past thirty years. The reason is decision making. Many investors are tempted to wait until times are good to buy investments, and they pay high prices. Or they choose speculative investments that have gone up a lot and end up falling a lot during corrections. Then when stocks fall, fear drives many investors to sell, locking in losses. Our Group already took care of the first part of this equation by avoiding speculative investments during the boom times. While it took discipline and courage to avoid speculative investments while they went up a lot, we are now reaping the rewards of our patience as some speculative investments have crashed 90% or more. We now face the second part of the equation, which is perhaps more daunting, and that's to prevent our clients from selling now that markets are in turmoil. We will do our best to counsel you and keep you invested.(3)

It's easy to understand the danger of trying to sit out times of market turmoil when you look at the chart to the left, which we've shown before. As you can see, if you missed just 10 key days in financial markets over the past 20 years, you nearly cut your annual return in half. That's ten key days out of about 5,000 trading days. You can understand why trying to move in and out of stocks is almost certain to fail.(5)

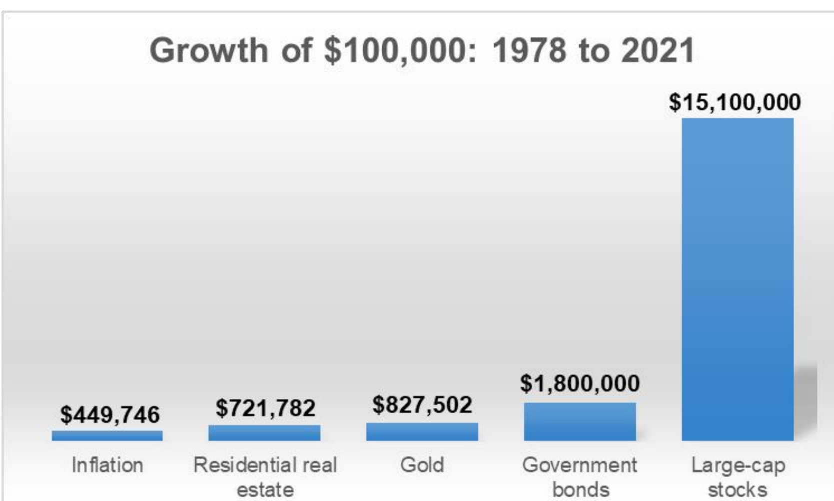
Source: Franklin Templeton

So, do not sell or attempt to move in and out of your investments is the first rule of surviving a bear market. A second rule is to invest in dividend paying stocks, so that you can reinvest the dividends into stocks when stock prices are depressed. We've mentioned before that the most similar period to the present economic time of high inflation and rising interest rates is the 1970s. While the Dow Jones index was flat from 1972 to 1982 as a result of high inflation and economic stagnation, investors who reinvested dividends into the Dow index over those ten years earned a 69% total return.(4)

The third rule of bear market survival is asset allocation. The key to this rule is preparing ahead of time. Investors living off their assets should always maintain three to five years' worth of living expenses in cash and bonds so that they can withdraw funds from relatively stable assets during times of stock market turmoil.

Finally, stop looking at your investment account balances. Doing so only increases the chances that you make a financially harmful decision out of fear. Checking your account balances won't make the inevitable recovery happen any faster.

Now, let's end this Commentary on a positive note and remind ourselves why we put up with the volatility of investing in stocks:



Source: Invesco

As you can see, stocks have outperformed all the major asset classes over the past 43 years. We expect a similar result to play out in the future. Investors who sit tight with their stock investments will greatly benefit from this long-term trend. Our Group will continue to work with you to help ensure that you make the right decisions during the current bear market in order to position yourself for success when the recovery occurs.(3)

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Sources:

(1) The Wall Street Journal
(2) First Trust
(3) Invesco
(4) Roger Thomas
(5) Franklin Templeton