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FINANCIAL STRATEGIES

Bear Market Playbook

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The New Yorker magazine recently ran an article with ideas on how to get through a lock down without losing your sanity. One suggestion is to watch Mary Tyler Moore as a reminder of when times were simpler. Gilligan's Island, however, is to be avoided because it may remind us of our forced isolation. In this piece, we are going to offer suggestions on how to get through a bear market without losing your mind, and hopefully your wealth. If the ideal were to happen, that this bear market is about over by the time you read this, keep it. Who knows when we will need it next?

When is a bear market over? The definition of a bear market is widely agreed upon; it is when stocks drop by 20% or more. Does that mean that when stocks go back up 20% or more, that the bear market is over? We don't think so. We think a bear market is over when you get your money back. Most people know exactly when that is.

We are not going to try to predict when that will be. Instead, we are going to make suggestions on how to proceed until that time, without too much stress, or worse, without potentially selling low and then buying higher. Maybe some of you have already done that. Don't feel bad, it happens to so many investors, and we believe more so in this bear market. One estimate showed $1 trillion coming out of the markets and into money market funds or bank accounts.[1]

Hersh Shefrin, a behavioral finance economist at Santa Clara University, agrees. "There's a psychological component: the pandemic wrecked people's illusion of control, triggering the amygdala, a part of the brain that's activated by fear, sending a rush of adrenaline that can create a high...then the body starts pumping cortisol if the threat continues – and that tends to diminish people's ability to engage in rational thought – creating panic."

This bear market has elements in play that make it different from 2008. And anyone who is a new investor in the last 11 years has never experienced a bear market. Besides the obvious Coronavirus Pandemic, there are election year anxieties, high-frequency trading, no-cost trading that causes less inhibition to selling, and there are index funds that can drag down an entire sector.

The media does not help, nor do the prognosticators who get the media's attention. We have long held that the media favors the prognosticators that are selling fear. Goldman Sachs received a lot of coverage when they predicted that GDP would fall 24% in the second quarter. The New York Times quoted an expert who predicted a level of poverty that "would exceed the peak of the Great Recession." The governor of California received a lot of press when he predicted that 25.5 million Californians would be infected by the coronavirus, hospitals would be overrun, and that desperate patients could die without ventilators.

The print media have nothing on the broadcast media. On March 2, CBS News predicted that the coronavirus might infect up to 70% of the world's population. On March 23, the low point of the market (we hope), CNN contributed to the panic with a story comparing this "plague" to author Sylvia Browne's book "End of Days."

What chance do buy-and-hold investors have of not letting fear affect their investment decisions when the media is predicting the end of days?

We try to help prevent clients from acting on panic but it is not our decision to hold or sell. One successful advisor we know says that he tells clients he will try to stop them the first time they want to panic and sell, but not the second. We try to be more helpful than that, doing as much as we can to remind clients about long-term goals.

Our experience is that clients who sell after a significant drop in the market generally can impair their ability to achieve those long-term goals. Investors are human beings, and the desire to sell is driven by emotion and fear. Listening to the news, or perhaps even friends, can trigger this fear, which leads to the natural desire to stop that feeling. Selling eliminates the fear of losing your life savings. But even if the market drops further, most likely you won't invest because there will be even more bad news at that point…that's what drove the market down more. Only the lack of bad news will make you feel like it is OK to invest again. But once the bad news is gone, stocks prices will have likely already increased…the market is relentlessly forward-looking. If at that point you buy, you just sold low and bought higher. And if you don't buy then? That's a tough situation.

We have been through the 2008 – 2009 bear market with many of our clients. It was very difficult. That bear market bottomed on March 6, 2009. Not only did we not know that was the bottom, but we can tell you that we did not even suspect it was the bottom. Stocks had been going down for 16 months, slowly at first, and then suddenly in the fall of 2008. Things had stabilized at the end of 2008 only to start badly in 2009, dropping another 20% to 666 on March 6 - the devil's low.[2] It felt like the financial world might just come apart. In that bear market, everyone we talked out of selling we helped. Might we face a situation where selling after an already significant loss makes sense? Yes, but we have never experienced this, and our country has not seen a bear market like that since the Great Depression. This is why we think the odds are quite high that selling sparked by a panic, at low prices, is going to be a bad idea.

We suggest you think of the stocks as businesses. Profits are paid out as dividends. Profits tend to grow over time, and so do dividends. Focusing on these dividends makes it easier to forget about the current price of stocks. Some companies are called dividend aristocrats. These are companies that have historically raised their dividends for 25 years or more. According to Investopedia, there are currently 57 of them. We like the following members of that club: 3M, Abbvie, Abbott Labs, Air Products, Becton Dickinson, Caterpillar, Chevron, Coca Cola, Colgate, Emerson, Genuine Parts, Illinois Tool Works, Johnson & Johnson, Leggett & Platt, McDonald's, Pepsi, Procter & Gamble, Target, United Technologies and Walmart.

There is a newsletter called Dividend Growth Investor. We want to quote from one of the contributors, Joe Ferris, from the March 27 blog. "I will get right to the point. What am I doing with the portfolio that I have nurtured for the past 25 years? I am not changing my current approach; I am waiting this out. Bear markets last for about a year or so on average, and have occurred 32 times in the last century. While they are happening, they feel absolutely awful. We check the news and the sky is falling and everything seems to be negative, at times confirming what we think our fears are. However, the skies will ultimately clear, investor panic ends, and the path resumes for further economic growth and continued innovation."

We hope this bear market ends like that series. After 98 episodes, the series was cancelled unexpectedly at the last minute. It just went away. We hope the virus just goes away. In the meantime, we are open and here to answer your concerns.

1 - Barry Knapp, Ironsides Macroeconomics, LLC

2 - FactSet