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Anatomy of a Recovery

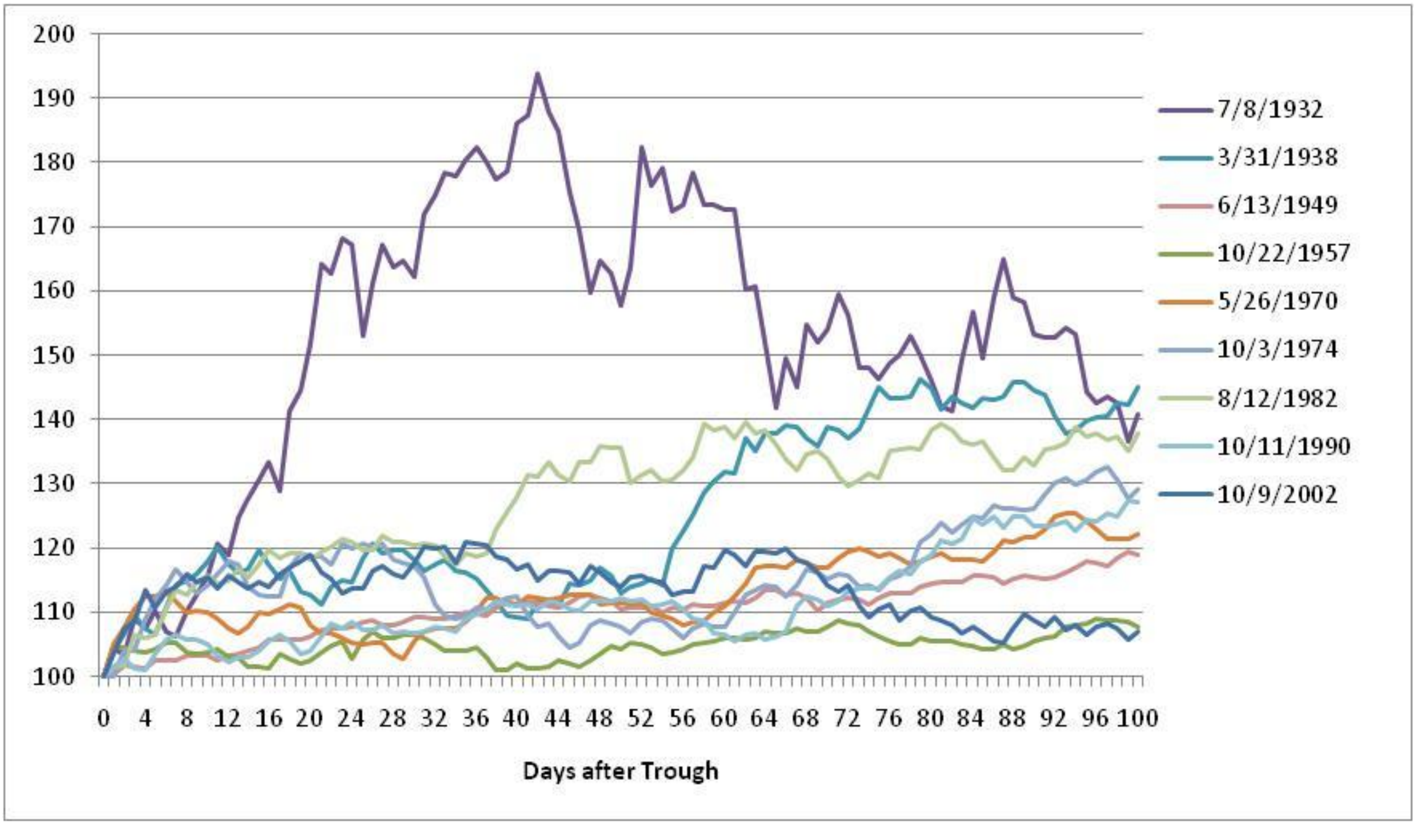
Recent market volatility underscores the risk associated with attempting to predict market turning points – one day can mean a return difference up to 10%. With hindsight, market turning points look obvious as we tend to forget about the probabilities ascribed to alternative outcomes (e.g. if the U.S. government would have actually bailed Lehman Brothers out or voted down the $700 billion rescue plan a second time). In the midst of a bear market, however, it is extremely difficult, if not impossible, to conclude that a rally is temporary or the start of the next bull.

Still, it is worthwhile to review how past market rebounds played out: not because we know that the recovery is upon us, but as a primer for the patience that is likely still required.

A review of U.S. Large-Cap stocks[1] (ignoring dividends) since 1926 indicates that there have been nine bear markets triggered by U.S. recessions (Table 1 in the Appendix). Excluding the 1929 bear market, market sell-offs typically lasted 20 months and cost an investor 34% on average. It then took an average of 33 months for U.S. Large Cap stocks to reclaim their previous day-end peak. From there, the market continued to march higher by an average of 87% over the next 46 months.

[1] Dow Industrial Average up to 1950, S&P 500 since

Behind every average lies a range of actual experiences. The chart below depicts how U.S. Large Cap stocks bounced back from their bear market lows over the first 100 days of recovery. On average, U.S. stocks rebounded 22%, with a range of 7% to 45%. A full 11% of that rebound – being half of the average rebound - was realized in the first 10 days. By the time investors wait for a market signal that the bull is indeed up and running, they likely have left a year's worth of return or more on the table.



If an investor chooses to wait for clear signs of economic recovery, lost opportunity is virtually guaranteed as, on average, the market rebound leads the economic recovery by three months (see Table II in the Appendix). The average recovery period expands to five months if the 2001 recession is ignored, which is justifiable given the initial market drop was driven more by overvaluation than economic contraction. That lag ignores the time it takes for economic growth stats to be tabulated, released and revised – meaning that it might take a half of a year into a bull market before solid evidence of an economic recovery is widely available.

Summary:

- ☐ Accurately predicting market turning points has more to do with luck than skill. Only with the benefit of hindsight are permanent recoveries apparent.
- ☐ Being out of the market when it starts to rebound is expensive. On average, the market returns 11% in the first 10 days of a recovery and 22% in the first 100 days.
- ☐ Recession-related bear markets require extreme patience; they last 20 months on average. It then typically takes 33 months to reclaim the previous index high. The total journey takes nearly four-and-a-half years and we are just over a year into this one.
- ☐ Patience is ultimately rewarded. After reclaiming the previous index high, a typical U.S. bull market climbs 87%, on average, over a further 46 months.

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APPENDIX

Table I – U.S. Large Cap Stocks Peak/Trough

U.S. Large Cap Equity Price Index (day end values)						
Peak	**Trough**	**Months**	**Loss %**	**Peak Reclaimed**	**Months**	**Months to New Peak**
6-Sep-29	8-Jul-32	34	-89%	17-Sep-54	266	
10-Mar-37	31-Mar-38	13	-49%	10-Dec-45	92	6
29-May-46	13-Jun-49	37	-24%	10-Apr-50	10	76
2-Aug-56	22-Oct-57	15	-21%	24-Sep-58	11	122
29-Nov-68	26-May-70	18	-36%	6-Mar-72	21	10
11-Jan-73	3-Oct-74	21	-48%	17-Jul-80	69	4
28-Nov-80	12-Aug-82	20	-27%	3-Nov-82	3	58
16-Jul-90	11-Oct-90	3	-20%	13-Feb-91	4	89
24-Mar-00	9-Oct-02	31	-49%	30-May-07	56	4
		20	**Ave Time to Reclaim Former Peak**		**33**	
			Ave Time to Form Next Peak			**46**

Note: Averages exclude 1929; index a combination of S&P500 and Dow Jones Industrial Average

Table II – Market Lead/Lag

S&P 500 Lead/Lag vs. U.S. Economy							
Index Peak	**U.S. Economy Peak**	**Recession Lead+/Lag- (months)**	**Index Trough**	**U.S. Economic Trough**	**Recovery Lead+/Lag- (months)**	**Contraction from Peak to Trough (months)**	**Expansion from Previous Trough to this Peak (months)**
Sep-29	Aug-29	(1)	Jul-32	Mar-33	8	43	21
Mar-37	May-37	2	Mar-38	Jun-38	2	13	50
May-46	Nov-48	29	Jun-49	Oct-49	4	11	125
Aug-56	Aug-57	12	Oct-57	Apr-58	5	8	94
Nov-68	Dec-69	12	May-70	Nov-70	5	11	140
Jan-73	Nov-73	10	Oct-74	Mar-75	5	16	36
Nov-80	Jul-81	7	Aug-82	Nov-82	3	16	76
Jul-90	Jul-90	(0)	Oct-90	Mar-91	5	8	92
Mar-00	Mar-01	11	Oct-02	Nov-01	(11)	8	120
Ave Recession Lead Time		**9**	**Ave Recovery Lead Time**		**3**	**15**	**84**

Source: NBER