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Brad Brain: The four truths of bear markets

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Brad Brain: "This is the fourteenth bear market since the end of the Second World War, plus a couple of near misses that were not technically bear markets, but were pretty close."

Right now we are in a “bear market.” That’s the term used when the stock market comes down by at least twenty per cent.

This is an interesting time because some younger investors have never seen a real bear market before. It’s been eleven years since the last nasty bear market, which means we have had an unusually long run of favourable markets.

Another oddity is how quick this one happened. Usually it takes months for the markets to trend down by 20%. This one happened in a couple of weeks.

But at the end of the day, this is just another bear market and, despite all the anguish and trepidation, we have seen this movie before and we know how it ends.

Here are the four truths of bear markets.

First, bear markets are a normal and natural part of a never-ending cycle. As long as the stock market follows the economy, and in the long-term that is the only thing that it can do, and as long as human nature doesn’t change, which it won’t, we will have bear markets.

It’s a cycle. We get some good times, but then we hit a rough patch, and then things turn around again, ad infinitum.

The second truth to know is that, in addition to being ordinary, bear markets are essential to the long-term outperformance of the stock market. It’s because of bear markets that investors demand a risk premium on their investment. If stocks were not volatile, then their prices, and thus their returns, would be bid down to a GIC-type performance range. The reason that the long-term returns after inflation for stocks are three times that of bonds is because the market demands it to compensate for the volatility.

The third truth to know is that bear markets are more common than you might expect. This is the fourteenth bear market since the end of the Second World War, plus a couple of near misses that were not technically bear markets, but were pretty close. We see a bear market roughly every five years.

Nobody can tell you in advance when they will start, or when they will finish, but they average out to be about a 30% decline, and usually last about 15 or 16 months. This one probably won’t be “average” because we took an elevator down, not an escalator.

By the way, this also means that we will have another bear market in another five years or so. Get used to the idea. With a bear market every five years you might see five or six of them during your retirement. Again, they are common occurrences.

Here's the fourth truth. Individual securities can come and go, but historically bear markets are the temporary interruption of a permanent uptrend.

Right now there are people that are probably thinking that the world is going to stop spinning on its axis and start turning backwards, causing the sun to rise in the west and set in the east. That's not going to happen. There are always people that think the world is coming to an end each and every time that we see a bear market.

Here's something else that you need to know. In the past 13 bear markets, the lows that were reached were never seen again. Chances are, when this thing bottoms out, you will never see these prices again.

You know what a bear market really is? It's an extended period of time during which the people who think that this time it's different sell all their common stocks at prices that will never be seen again to people who understand that this time it's never different.

All objections to these four truths are based on the hypothesis that this time it's different. This time it is not different. It never is.

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