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Bull Or Bear: Should Investors Still Care?

With the stock market in full swing, investors are questioning whether the end is nigh. This month, we review bull and bear market cycles past, and observe the difference between cyclical and secular periods. With the benefit of hindsight, we conclude that assigning market labels can be challenging, devilishly tricky, and, at times, even imprecise.

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Not a day goes by without hearing what appears to be the predominant question for investors, namely, When will stocks come back down to earth? Variants of that query include, Isn't this bull market getting long in the tooth? And, Stocks go up and up, so we must be on the verge of a sell-off, right?

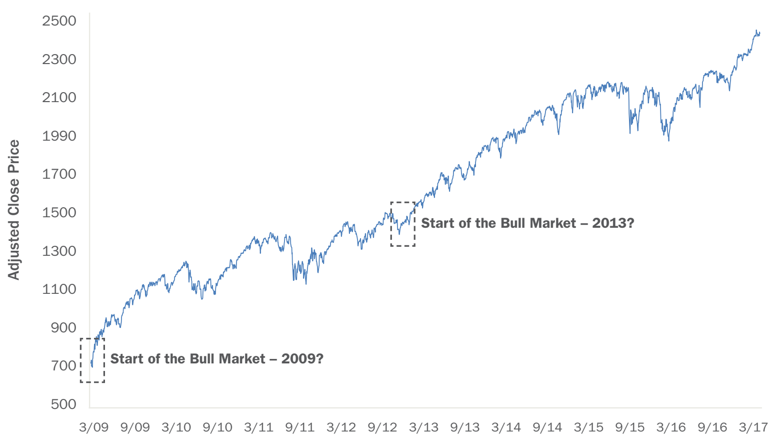
These questions are not about a pullback *per se*. No matter the market, corrections of 5%-10% are always possible and even to be expected. Rather, most of these concerns stem from a common reading of the past investing years. To wit, that we are in a robust bull market in US equities that began at the tail end of the financial crisis. Remove that assumption, and a multitude of other possible interpretations emerge. As Barry Ritholtz, one of the more astute market observers who worships few, if any, sacred cows, recently and acerbically observed, most of what people think they know about when to call market cycles is wrong, and now especially.

In that spirit, we suggest that the nomenclature of "bull" and "bear" markets is flawed at best, and damaging, at worst. It assumes clear demarcations that most experienced players in the market ought to recognize as both simplistic and misleading. Although understanding where one is in long market cycles is certainly important, few seem to have a good feel for when to mark what. Going forward, therefore, it might be best to abandon these terms altogether.

What market are we in?

On March 9, US stock markets "celebrated" the eight-year anniversary of the low hit in 2009 marking the heart of the financial crisis. That led, predictably, to a slew of headlines with birthday wishes. Most of those, however, had as much cheer as sending well wishes to a terminally ill cancer patient. *Fortune* was typical: "It's the Bull Market's 8th Birthday. Wall Street Analysts Aren't Celebrating." The article continued to report widespread sentiment that the bull has or is about to peak, with predictable references to concerns about valuations, future earnings, rising interest rates, possible inflation, plateauing margins, and uncertain sources of future revenue growth.

Figure 1:
A Bull Market For Equities Since 2009 or 2013?



Source: Yahoo Finance. S&P 500 represented by GSPC.
Chart reflects adjusted close prices for GSPC from 3/2/2009 to 3/17/2017.

Figure 2:
… Or Beginning of Secular Bull Markets After a Secular Bear Market?

Source: Yahoo Finance. S&P 500 represented by GSPC.
Chart reflects adjusted close prices for GSPC from 3/1/2000 to 3/17/2017.

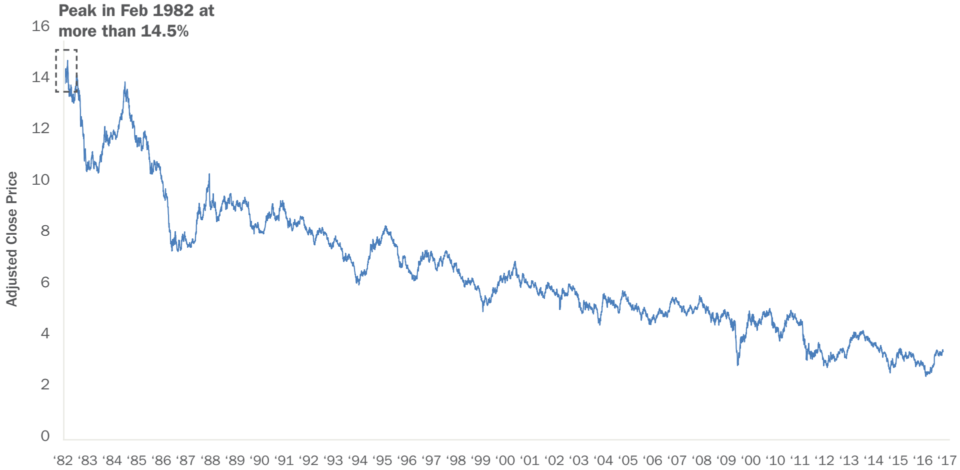
But using March 9 as the start of a bull market is questionable at best. As Ritholz points out, taking the low point as the start of a new bull market would lead to a different time frame for what have become established markers for earlier bull markets, such as 1946-1962 and 1982-2000. If the low point had been used in those cases, our date marking the beginning of those bull runs would be many years earlier. Instead, we use the date on which the market recouped its losses and marked new highs as a starting point, which, in the present case, puts the bull market beginning in 2013, rather than 2009 (Figure 1).

There is also the distinction between "cyclical" markets and "secular" ones. The latter are shorter lived and can occur in the midst of an opposite secular cycle, meaning that there can be bull-market spurts in the midst of longer-trend bear markets, or bear-market periods in the midst of secular bull markets. In multiple periods in the 1970s, markets surged 50% and more only to collapse. On the flip side, there were sharp "bear" periods in the late 1980s and throughout the 1990s; the infamous Black Monday of October 19, 1987 is probably the most remembered. In many periods in the 1990s, stocks pulled back in excess of 20% (the accepted definition of a bear market).

Secular markets can last decades, meaning that even if the periodization putting the current equity bull market at eight years old were correct, there could be at least a decade left in this secular bull market before we could say that it is getting old or stretched. Secular trends can, and usually do, last more than eight years. In today's short-termism, however, eight years can feel like an eternity, which may be why so many are so sure that the cycle is nearing an end, and so dismissive of the idea that we may be in the middle, or even early stages, of a longer secular trend (Figure 2).

Add to that the fact that periodization is only truly clear in retrospect. After Black Monday in 1987, many were certain that darker days were ahead. That was about as wrong as wrong can be.

Figure 3:
A Secular Bull Market for Bonds?



Source: Yahoo Finance. 30 Year U.S. Treasury represented by TYX.
Chart reflects adjusted close prices for TYX from 1/4/1982 to 3/17/2017.

Even more instructive is what happened in 1994. That year, as the US economy was gaining traction, the Federal Reserve began raising short-term rates. The result was a sharp surge in yields, especially on the 30-year bond. That helped trigger the Mexican peso crisis, and also contributed to a sell-off in global equities and a scant 1% return for the S&P 500, with many months of volatility. Many investors legitimately forecast that the bull market in equities was over, as was the bull market in bonds that began around the same time in 1982 (Figure 3). Those forecasts made perfect sense at the time, and were bolstered by compelling evidence of frothy equity valuations, inflation fears, rising interest rates, and global uncertainty. As we now know, however, 1994 was simply a pause in the midst of a powerful secular bull market in both equities and bonds that would not only start again in 1995, but also gather even more momentum in subsequent years.

In a similar vein, many perceived the choppy equity markets of 2007-2008 as an understandable response to the end of the housing bubble, but not as a harbinger of the end of the strong run that markets experienced after the October 2002 lows. Most commentators, along with the "smart money" and informed investors, believed that a new bull market began in October 2002, and questioned in 2007 and early 2008 whether it was getting overextended. Looking back, we now view the post-2002 period not as the beginning of a new bull market, but rather, a bull-market trend during a bear market that began in 2000.

How can we resolve our need to understand where we are in a cycle and the fact that we rarely get the cycle right while it is happening? One tact would be to allow for probabilities. That suggests that rather than just slapping on a label of "bull" or "bear," we would accept as a given that knowing precisely where we are in a cycle is challenging, and we should consider multiple possibilities, which might then be ranked in order of likelihood.

Allowing for a broader range of possibilities still leaves too much uncertainty for most investors. That is why asset allocators, as opposed to traders or managers who have higher turnover of holdings, think in terms of expected returns over a longer period, such as a decade. Those expected returns are based on past patterns, for sure, but they implicitly allow for bouts of volatility and confusing signals, and demand that investors by and large ignore them. Allocated portfolios, therefore, do not trade and rebalance because of a year like 1994. On the downside, they also do not shift radically because of a massive sell-off, such as 2008-2009, because of the bias towards expected returns. When a sharp rift occurs, the discipline of holding the course can be painful.

Recognizing the longer trend, however, is vital. That doesn't mean an easy recourse to bull and bear labels, but it does mean an awareness that secular cycles tend to last more than a decade, and usually closer to 15 to 20 years. Of course, with the speed of algorithmic trading and electronic transactions, it may be that cycles and trends are accelerating and hence shortening. We will not know that for certain until it is clear in hindsight. But current market dynamics suggest that the longer secular trends are not being disrupted. If that is the case, then the present secular trend of stocks on the rise is not particularly old. Only the secular trend of rising bond prices and declining yields is old: 35 years from 1982 to the present. It may be that we will look back at late 2016 as the end of that multi-decade secular bond bull – or not.

The best course, therefore, is to eschew "bull" and "bear" as short-term cyclical markers and reserve them only for longer secular trends, with the full humility and awareness that it is almost impossible to be clear except in retrospect. We now have 17 years of information about equities peaking in 2000, plunging in 2002, peaking in 2007-2008, plunging in 2009, and peaking again after 2013. That looks more like a secular bear market that only recently ended, meaning that if we are indeed in a secular bull market, it is far from old and far from spent. Whether or not we are indeed at the beginning of a robust bull market period is another story, but don't let facile use of misleading markers cloud what is always a devilishly tricky analysis. ■

March Takeaway:

The tendency to label markets as "bull" or "bear" runs rampant, but its accuracy is apparent only in hindsight. Seventeen years of market history suggests we may at the end of a secular bond bull and only recently at the beginning of a secular equity bull market, but humility about the difficulty of identifying secular shifts as they are happening is vital. Maintaining asset allocation and resisting the impulse for misleading and simplistic demarcations may be a more prudent strategy.

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