WHAT TO DO IN A BEAR MARKET

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We're officially in a bear market. At least, that is according to the S&P 500 Index, the most frequently used benchmark for investors. A bear market is typically defined as a broad-based market selloff of at least 20 per cent or more. So far this year (at time of writing), the S&P500 is down ~22 per cent.

Here's what successful investors need to know. While stocks have been the best performing asset class throughout history, **bear markets are fairly common.** In fact, over the past 75 years (from 1947 to 2022), the market has persevered through 14 bear markets, about once every five years.

Given the fact that most investors will need to own equities (at least to some extent) in order to reach their financial goals and given the frequency of bear markets, **I believe we must learn to not only survive but to also thrive during any large market drop.**

To help you do so, I've created the following checklist for investors to keep on hand as a reference for what to do during this and any other bear market.

Keep things in perspective

Financial news doesn't provide much, if any, perspective during a large market drop. Their preference of course is to sensationalize each and every temporary downturn with doom and gloom, using words and phrases like "unprecedented", "crisis", "meltdown", "worst ever" and "end of the world". Every bear market simply can't be the "worst ever", and every blip is truly not an actual "crisis". As we all know, bad news sells. This creates panic among the uninitiated, leading many to sell stocks at the worst of all times.

Meanwhile, you and I know that the novice investor's crisis is the savvy investor's buying opportunity. "Bad news" is "good news" to the long-term focused, opportunistic investor. By maintaining some much-needed perspective, we can see a bear market for what it truly is: a relatively short-term phenomenon that "comes with the territory". Of course, the market goes up over the long term.

The difficulty, and opportunity, lies in the fact that the market's long-term upward trajectory is routinely interrupted by relatively short-term declines. The average bear market lasts about 9.6 months, whereas the average length of a bull market is 2.7 years.

Let's keep in mind – the bull/bear cycle of the stock market is simply a loose reflection of the economic cycle. For the intelligent investor, a bear market is like water off a duck's back.

"The market is always making mountains out of molehills and exaggerating ordinary vicissitudes into major setbacks."

- Benjamin Graham

Remember the lessons from the past

What can we learn from every other large market drop that has occurred in the past? The 2008/2009 global financial "crisis" turned out to be the buying opportunity of a lifetime. And the huge and sudden market drop we witnessed in February/March 2020 (the pandemic/COVID selloff) was promptly followed by an equally large stock market rally in what has been described as a "V-shaped" recovery.

According to a study done by the Wells Fargo Investment Institute, the average one-year market return after the end of a bear market is 43.4 per cent. And after a market correction of just 10 per cent or more, the two-year average annual rate of return thereafter has been 37.3 per cent.

So what can we learn from past bear markets? They have always been temporary, and they provide savvy investors with wonderful buying opportunities!

"Most people get interested in stocks when everyone else is. The time to get interested is when no one else is. You can't buy what is popular and do well."

- Warren Buffett

Focus on your goals and not the markets (i.e., the "noise")

Unsuccessful investors spend far too much time focusing on the news, the economy and the market's ongoing short-term gyrations. They're focusing on matters that are completely beyond their or anyone else's control. Successful investors see this for what it is: the noise. They're focused on matters that they can control, like how they react to market extremes. Most important, they remain fixated on the achievement of their long-term financial goals – not what the market did yesterday, last week or last month.

Remember why you're investing in the first place: to build wealth for your retirement, to help fund a child's post-secondary education or to fund your income needs during retirement – just to name a few. In any case, how does short-term market volatility impact your long-term goals? The answer: it doesn't, or at least, it shouldn't.

The current headlines and recent market moves (up or down) are just noise. The achievement of your (again) long-term financial goals is all that really matters. If you're still not convinced, ask yourself this question, "How will panicking during a temporary market decline help me reach my long-term financial goals?"

"Unsuccessful investors react: they make significant changes to their portfolios in response to real or imagined economic or market crisis. All financial success comes from acting on a plan. A lot of financial failure comes from reacting to the market."

- Nick Murray

Focus on dividends (not price fluctuations)

Treat your portfolio like an apartment building. If you own an apartment building, would you focus on the month-to-month or year-over-year change in the market value of the building itself, or would you focus on the rent you're collecting each and every month? I'm pretty sure most landlords focus on the rent, knowing that while the market value of the real estate itself will indeed fluctuate in the short term, over time it will go up in value. Successful investors are keenly focused on the income from their portfolios, and they will continue to invest in their portfolios throughout each and every temporary drop. Most important, like the owner of an apartment building, they're in it for the long term.

One last point on this. Just like a good operator of an apartment building, you receive "rent" (in dividends), which will also likely go up over time. But even if the company itself doesn't increase the amount of dividends it pays, savvy investors can increase the dividend yield they receive during a bear market by **buying dividend-paying stocks at temporarily low prices** (i.e., during a bear market). All else being equal, during a bear market – when stock prices have just dropped by 20 per cent or more, this also means dividend yields have gone up by 20 per cent or more. **This is where retired clients can actually give themselves a raise during their retirement years!**

So remember: what do dividend yields do during a bear market? They go up!

"The investor who permits himself to be stampeded or unduly worried by unjustified market declines in his holdings is perversely transforming his basic advantage into a basic disadvantage."

- Benjamin Graham

Be patient

You didn't buy your last home and then immediately proceed to check its market value every day, week or month. Why? You're not a "short-term" homeowner, and you're not a short-term investor either. Besides, if your home did so happen to drop precipitously in value after you bought it, you most certainly didn't immediately panic and sell it.

You are a "long-term" homeowner, and by default – you are also a long-term investor. Patience may very well be the most critical key to your investment success.

Large market drops and recessions don't last forever. The market will return to its upward trajectory in due course. In order to reach your financial goals, you must remain in the market in order to participate in the inevitable rebound.

"The market is the most efficient mechanism anywhere in the world for transferring wealth from impatient people to patient people."

- Warren Buffett

Be opportunistic

You don't actually lose any money whatsoever in a bear market. A stock market drop is a temporary decline in the market value of your investments, **on paper.**

The truth is, the market doesn't cause investors to lose any money whatsoever. Investors cause investors (themselves) to lose money during a bear market, by selling when their investments have temporarily lost some of their value, on paper. By selling at low prices, the investor (not the market) is turning a paper loss into a real loss. That's not the market's fault, that's the investor's fault.

"Smart money" recognizes that a bear market is when we should be buying stocks – not selling them. During the second half of the past recessions, equities went up by an average of 22.3 per cent. Again, this occurs during the recession. In other words, if we wait until the recession is over and the media give the "all clear" signal, we will have already missed a large part of the market's recovery.

"Bear markets are where the real money is made – not lost.""

- Warren Buffett

Remember that investor sentiment is a contrarian indicator

Economic indicators such as consumer sentiment and investor confidence are contrarian indicators. Historical sales flow data consistently reveals that the investing herd is repeatedly piling into stocks at or near market highs, when the risk has gone up and future return potential is the lowest. And conversely, the data shows that investors are fleeing equities for the false safety of cash at or near a market bottom, when risk is much lower and future return potential is much higher.

Don't be a "contrarian indicator". Successful investors are successful because they routinely go against the herd.

"Be fearful when others are greedy and greedy when others are fearful."

- Warren Buffett

Look forward, not backward

During a bear market, much of the doom and gloom you're hearing about in the news – and that you yourself may be concerned with – is typically already priced in to the market. The stock market generally moves **in anticipation** of the economic outlook – good or bad. During a bear market, stocks prices typically move in anticipation of the better news that will inevitably come.

Looking at today's market climate, **a recession is on the horizon** – and some might say, "Winter is coming". But as forward-looking investors, that also means spring is coming too!

When the market has gone up too much, it often corrects while the news is still good – again, anticipating the fact that the economy won't stay "hot" forever. This is simply known as the business cycle, the profit cycle or the economic cycle. **When looking backwards, investors are always doing the wrong thing at the wrong part of the cycle.**

In tennis, this is referred to as being "wrong footed", moving in the wrong direction at the wrong time. We want to be trimming equities/adding to cash when the investing herd is euphoric, and we want to be using that cash to then buy more equities when the consensus is poor and when stocks are cheap.

"Selling out at the bottom – and thus failing to participate in the subsequent recovery – is the cardinal sin of investing."

- Howard Marks

You don't own "the market"

The returns the media reference during a bear market are the returns for a stock market index, typically the S&P 500 Index (U.S. equities), the NASDAQ Index (the "tech" sector) or the TSX Index (the Canadian stock market).

So if the media are reporting that "the market" is down 20 per cent for example, that would only be applicable to you if you own "the market", i.e., an unmanaged index like an exchange traded fund (ETF).

Keep in mind – you don't own the market, and you're not in an unmanaged portfolio. You own an investment plan, not an index.

"A stock is not just a ticker symbol or an electronic blip; it is an ownership interest in an actual business, with an underlying value that does not depend on its share price."

- Jason Zweig

Control your emotions

While we can't control what the market does, we can control how we react to it. "Smart money" takes a contrarian point of view, selling to euphoric buyers and buying from panic-stricken, despondent sellers. In a nutshell, this approach is how Warren Buffett became a billionaire and the world's greatest investor.

During any market extreme (high or low), let's remember to keep our emotions in check. The chart below should be a frequent point of reference.

Emotional Tendencies vs. Reality

Source: Raymond James Ltd.; For illustration purposes only

"Great investors are not unemotional, but are inversely emotional – they get worried when the market is up and feel good when everyone is worried."

- Bill Miller

Seek the wisdom of truly successful investors (not the media!)

Who should you get your investment advice from: the guy on the news, an investing blog or podcast, your uncle or cousin (who has an opinion on everything)? Or should we seek investment wisdom from some of the world's greatest investors?

"Warren Buffett, Charlie Munger, and Benjamin Graham have figured prominently in our investment style. If you're going to copy someone's behavior and philosophy, you should pick one that has worked."

- Larry Sarbit

And finally, remember that optimism is the only realism

The reality is the stock market has gone up (a lot!) throughout history. A pessimistic investor is betting against that history.

Yes, we will continue to see volatility, many more market corrections, bear markets and recessions. **But the long-term trajectory has always been, and likely will always be, up!**

"Headlines, in a way, are what mislead you because bad news is a headline, and gradual improvement is not."

- Bill Gates