Richard Bernstein Advisors

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RBA Quick Insights

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Bubbles and bears

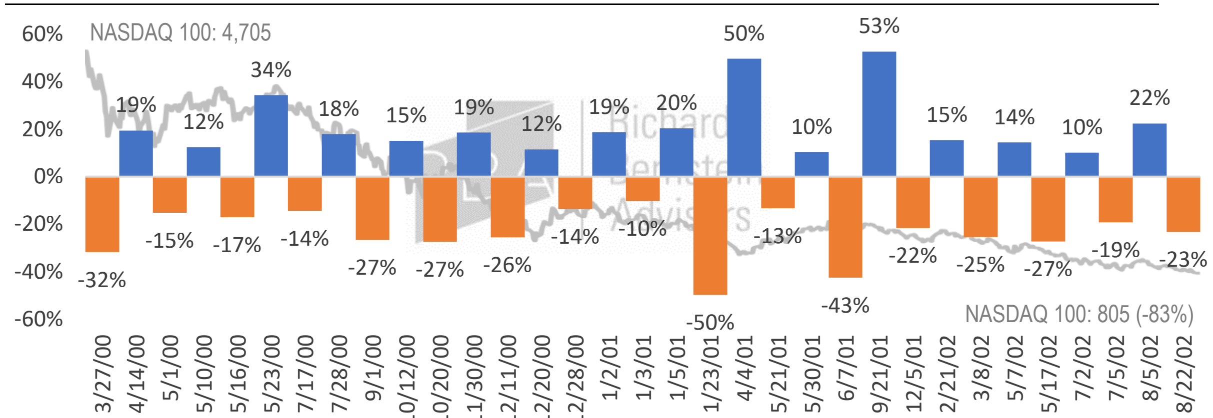
Bear markets always signal a change in leadership

Very few market rules, technical or otherwise, withstand the test of time, mostly owing to the efficiency of markets. But here are two that you can count on: (1) future cycle leadership is never the same as prior cycle leadership, and (2) bear markets always signal a change in leadership. Thus, this year's sell-off has been the market's way of trying to hit investors over the head with the idea that they should avoid clinging to yesterday's winners, but few seem to be listening.

Bubbles don't deflate overnight

Rather than rotating portfolios away from bubble assets, investors tend to view the initial price declines as attractive opportunities to buy secular growth at huge discounts. Yet the history of bubbles suggests that they don't return to being great investments after just six months of selling off. During the Tech crash in 2000-2002 — a bear market which lasted 2.5 years — the NASDAQ 100 Index had 16 distinct bear market rallies exceeding 10% during its 83% decline, with three of those rallies greater than 30% (Chart 1).

Chart 1: NASDAQ 100 10%+ moves during Tech Crash (March 2000 – October 2002)



Source: Richard Bernstein Advisors LLC

Better to be late than early

Many investors insist on buying early so that they "can be there at the bottom." Yet history suggests that it's better to be late than early. In a refresh of our previously published analysis, we analyzed the returns for the full 18-month period encompassing the six months before and the 12-months after each market bottom. We then compared the hypothetical returns of an investor who owned 100% stocks for the entire period ("6 months early") with one who held 100% cash until six months after the market bottom, then shifted to 100% stocks ("6 months late"). In seven of the last ten bear markets, it has been better to be late than early (Chart 2). Not only does this tend to improve returns while drastically reducing downside potential, but this approach also gives one more time to assess incoming fundamental data. Because if it's not based on fundamentals, it's just guessing.

As an aside, the only instances in the past 70 years where it has been better to be early were in 1982, 1990 and 2020. But in each of those instances, the Fed had already been cutting interest rates. Given the high likelihood that the Fed will continue to tighten into already slowing earnings growth, it seems premature to be significantly increasing equity exposure today.

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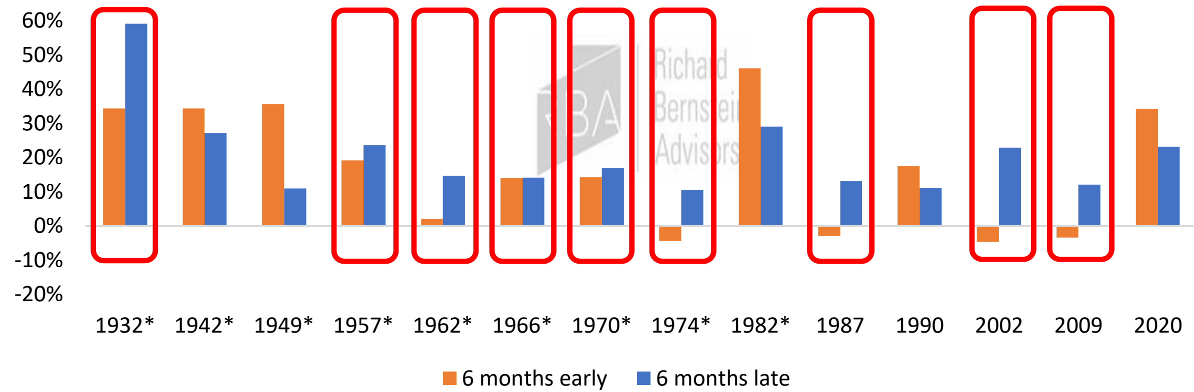
Chart 2: Total returns starting from six months before bear market troughs and ending 12 months after the trough



Source: Richard Bernstein Advisors LLC
*based monthly trough dates prior to 1987, determined by the lowest month-end S&P 500® level adjacent to the month of the bear market date
Note: "6 months early" assumes S&P 500® returns for the full 18-month period. "6 months late" scenario assumes 3-month Treasury Bill returns as a proxy for returns on cash for the 12 months and then S&P 500® returns for the final 6 months. Treasury Bill returns prior to 1982 are based on Ibbotson data.
Circles denote periods where returns were better for the "6 months late" approach.

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