The bear market comes out of hibernation

“What did the market do today?”

Of course, we understand when people ask this question they’re usually referring to a broad index like the S&P 500, which today is less than one month into a bear market (defined as a decline greater than 20%) and which two weeks ago was –23% from the top (it’s now –18% after a minor rally). Although this might sound painful, it’s just “meh” as bear markets go. Since the 1920s, the average bear market has lasted about 9.5 months and has seen a decline of –38%. This suggests we may be less than halfway to the bottom with respect to performance, and around 3 quarters from the bottom with respect to duration.

Remember we’re talking about averages, so it’s important to understand how prior bear markets have varied from the mean. Excluding the Great Depression, which we all know about, the shortest bear market in modern history was in 1990; it lasted only 3 months and at the low was –20%. By contrast, the worst bear market in modern history accompanied the mortgage meltdown. It lasted 18 months and was –56.8%.

Is there reason to expect this bear market will be better or worse than average? On the bright side, the economy still looks strong, we have a super-healthy banking system, and the Federal Reserve has perfected the art of propping up ailing markets. On the dark side, we have unprecedented debt levels across the board (state, federal and private sectors), overwhelming political dysfunction, and rising interest rates.

If we’re parsing this information in search of market direction, here’s an important insight: different sectors of the stock market have lives of their own, and they often give us better information than the broad indices. A good rule of thumb is that the high-octane sectors lead on the way up and lead on the way down, so they act as a sort of canary in the coal mine. A case in point is biotech, which is already 16 months into its worst bear market in 20+ years. At a recent bottom, biotech (as measured by the XBI index) is –61% since February, 2021. Rather than just heading into a bear market, like the S&P 500, biotech may be coming out the other side.

A similar though less severe pattern can be seen in tech, which peaked in December, 2021, and early this month was down –30% (XLK index). Other sectors we care about include global mining, which is –31.3% from a top in April of this year, and junior gold miners, which are –42% since a top in August, 2020.

The takeaway when you look at these individual sectors is that they tell different stories. The S&P 500 is probably telling us we’re in the first innings of a several quarter bear market. Biotech, which historically runs about a year ahead of the broad market, may be telling us it has bottomed…and it’s safe to start building long positions. The message from tech and mining is for now less clear… perhaps it’s simply “the jury is still out.”

A broader takeaway is that bear markets aren’t good or bad. They’re just part of the ebb and flow of financial life…like a rain shower on a summer day. Take comfort in the fact that the average bear market is short (around 9 months), while the average bull market is much longer (around 3 years). It’s also useful to know that contrary to popular belief, bear markets and recessions don’t go hand in hand. In the past, one has followed the other only about half the time.

In addition, recognize that bear markets are the ultimate teachers of market wisdom, so pay attention! They teach risk management, risk tolerance, and human psychology. They introduce you to your investor self, and what you learn will make you a much better and smarter investor.

Finally, the best thing about bear markets is that they’re a bargain shopper’s paradise. You can bet your life that over the next several quarters you’ll be reading about Warren Buffett spending boatloads of cash he accumulated over the past several years.

Maybe you should think about following his lead.