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FINANCE • BEAR MARKET

Welcome to your first bear market. Here's what it means

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Bear markets have come out of hibernation.

The Dow Jones Industrial Average closed down 5% Wednesday, making it an official bear market. The S&P 500 and the Nasdaq are on the verge of entering bear territory. The Russel 2000 small cap index, for its part, was still trying to recover the highs it hit before its last bear market, back in 2018.

And with the way stocks have been plunging the last few weeks, and how futures are pointing this morning, the potential for all indexes to go bear appears imminent.

But, what does any of that mean?

Technically speaking, a bear market happens when stocks fall 20% from recent highs. That's not inherently bad.

"It's a healthy part of capitalism to flush out the system every once in a while," said William Zox, chief investment officer of fixed income at Diamond Hill Capital Management.

Over time, corporate valuations, profit margins, and use of leveraged debt can expand beyond companies' ability to sustain or justify them. A bear market chills everything down and gets everyone ready for the next expansion.

The current bull market is the longest on record: 11 years as of its recent anniversary, which, ironically, was during Monday's big rout. Millions of young investors, though, have never known anything but an ongoing upward financial march, which a few hiccoughs here and there. This is a time when some knowledge can be useful.

Bear species

A bear market doesn't necessarily happen all at once. Like on Wednesday, when the Dow dropped to that level but the Nasdaq stayed above the fray. And while all bear markets imply a steep fall in stock values, they differ in degree, and also in type.

There are three forms of bear market, according to Jill Fopiano, CEO of O'Brien Wealth Partners: event-driven, cyclical, and secular. "The event driven is the result of a one-off type of shock," she said. A war, perhaps, a natural disaster—or a pandemic virus that creates fear among people. Hopefully something that clears up quickly.

The cyclical type of bear market is actually a bear market inside of a bull one. They can last a few months to a couple of years. In December 2018, overall stocks were in a correction, dropping more than 10%, while financial stocks were in a bear market as they had dropped at least 20%.

Then there's a secular bear market, the type that includes the dot-com crash in the early 2000s and the Great Recession that started in 2008. "A secular bear market typically lasts longer," said Rob Isbitts, founder and chief investment officer of Sungarden Investment Research. Some have dragged on for a decade or more.

There's also a different feeling to them, Isbitts said. "In a cyclical bear market, people don't really lose confidence in investing for growth. In a secular bear market, they do because the losses are deeper and more chaotic." As he noted, in both the dot-com and Great Recession bear markets, markets lost about half of their value.

What is currently happening reminds Isbitts of a secular bear market, or at least the beginning of one, suggesting this could last a while.

Panic and fear

Ultimately, bear markets are a psychological issue—a matter of popular perception and not necessarily bottom-line economic reality.

"If you tell me that over the last two weeks that the true value of Microsoft and [Google parent] Alphabet have dropped so significantly, I don't believe it," said Fordham University senior lecturer of economics Giacomo Santangelo. "You can't look at the [strong] labor market report from last week, and say this is the worst economy."

But if people begin panic-selling and the contagion of fear catches, it can become self-sustaining.

Still, despite the panic that bear markets can cause, it's important to remember that a bear market is by no means a definite harbinger of bad economic times. While stocks are an economic indicator, the economy is much broader. The potential for real economic damage comes when a shock extends beyond market panic and into supply chains and consumer demand.

"It becomes a question of how disruptive this is going to be to U.S. manufacturing," Santangelo said. "How disruptive is this going to be to Chinese manufacturing, because then that's disruptive to U.S. consumption."

Unfortunately, the biggest investor question about bear markets—how long they might go on—is the most difficult one to answer. "If I could tell you how long a bear market was going to last, I've be having this conversation with you from a beach," Santangelo said. "It depends on people."

When those people think markets have hit bottom and begin to think investing is too good to pass up, conditions could quickly turn around. Until then, people may direct their investments toward hand sanitizer, toilet paper, and panic.

https://fortune.com/2020/03/12/bear-market-secular-cyclical/