MARKET VIEW

# Equities: A Teachable Moment

*January 22, 2019*

*January 2019 is reminding us all that, historically, time in the market, not timing the market, is the more productive investment strategy.*

**In Brief:**

- Investors who exit the market during a downturn may have regrets later, because when markets recover they tend to bounce back quickly.
- A bull market can last a long time, but a significant portion of its gains typically occurs during the early months of the rally.
- The worst year might be the best time to invest, as valuations decline and stock prices go "on sale."

The year 2018 may have been the worst for U.S. stocks in a decade, but it was also, oddly enough, an unusually negative December that made it so. According to Ibbotson data, the final month of 2018 was the worst December for the Dow Jones industrial average since 1931. In one seven-day stretch during the month, according to cnbc.com, the Dow fell by 350 points or more six times. The S&P 500® Index was up or down more than 1% nine times in December.

Up to that point, the market had been on a favorable trend. The S&P 500 had set an all-time record on September 20, 2018, and the Dow industrials had closed at a record on October 3.

Whatever the reasons for December's slump—including concerns about U.S. Federal Reserve (Fed) policy and trade issues with China—by year-end, even after a rebound late in the month, investors had lost so much ground that, for many, the year 2018 resulted in low, or no, returns.

As of January 18, however, the S&P 500 is off to its best start in years, up 6.5%, with the Dow industrials not far behind, at 5.9%. While such performance is not a guarantee of what the rest of the year will be like, it does offer a teachable moment for investors. Here are two of the most important lessons:

### Stay Invested: A Market Rebound Can Happen Quickly

Some of the worst investment decisions are made during difficult times, especially when investors bail out of equities after periods of market downturns, thinking they can jump back in "when the time is right." But when markets recover after a bad spell they tend to bounce back quickly.

A bull market can last a long time, but a significant portion of its gains typically occurs during the early months of the rally. Investors who flee to cash during a market slump should keep in mind the potential cost of missing the early stages of a market recovery, which historically have provided the largest percentage of returns per time invested.

According to Standard & Poor's, historically, going back to 1926, the average return one year after the typical bear market is 38.4%, but returns diminish as time goes by to 19.8% three years after a bear market ends. .

The financial crisis of 2008-09 provides a good example. After declining by nearly 40% in 2008, the S&P 500 Index continued its drop until it bottomed at 683 on March 9, 2009. From there it rallied over 100% in the first 48 months of what was to be a long bull market recovery. Investors who were still out of the market in 2011 lost an opportunity for potentially substantial gains.

The year 1987 offers us another vital lesson, one that is quite relevant to today's market. That was the year of the October 19 "Black Monday" stock market crash, the largest ever one-day percentage decline in the Dow Industrials. Those who stayed fully invested in the market following the 1987 crash benefitted from being present for the best-performing days during the following years. Those who were along for only some of those days, or who missed them entirely, realized far lower returns.

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**Table 1. After 1987, Stock Investors Who Didn't Stay In Lost Out**
*Annualized return and growth of $10,000 for indicated periods*

| Since 1987* | Annualized Return | Growth of $10,000 |
|---|---|---|
| All Days During Period | 11.20% | $201,724 |
| Missed the 10 Best Days | 8.50% | $100,673 |
| Missed the 20 Best Days | 5.90% | $62,395 |
| Missed the 30 Best Days | 4.30% | $41,073 |

Source: Standard & Poor's and Lord Abbett. Returns are measured based on the S&P 500® Index. The "best" days to be invested are defined as those on which the S&P 500 Index delivered its highest returns for the given periods based on historical data. Annualized return and total return assumes the reinvestment of all dividends and/or capital gains.

*01/01/1988–12/31/2018.

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A bull market is defined as a 20% rise in stock prices from a bear market which, in turn, is defined as a 20% decline in stock prices. By definition, therefore, new bull markets are not known until stock prices have already increased by 20%. Investors who are prone to move entirely out of stocks during bear market declines might want to reconsider such action, as attempting to properly time the beginning of a new bull market can have unhappy results.

**Think Counterintuitively: The Worst Year Might Be the Best Time to Invest**

For investors with cash, a bear market can offer buying opportunities. Historically, the S&P 500 price- to-earnings ratio (P/E) has been notably lower during bear markets. When investors are more confident, the P/E ratio typically increases, making stock valuations higher. During a market slump, stocks are frequently considered "on sale." As noted in **the January 7 *Market View***, valuations dropped below their long-term averages in the fourth quarter of 2018—a bullish event, particularly as fundamentals appear resilient.

## The Bottom Line

The bottom of the market is very hard to identify at the time it is happening and, as we've shown, investors who panic during a downturn often miss gains early in the recovery. Rather than trying to time the markets, it's important for investors to remain focused on their long-term goals and create appropriate asset allocation strategies to achieve them. As difficult as 2018 was for many investors, it did not mark the end of investment opportunity.

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The **price-to-earnings *ratio***, or ***P/E*** is the *ratio* of the market price of a company's stock to its earnings per share (EPS): ***P/E Ratio*** = Market Value per Share.

The **S&P 500® Index** is widely regarded as the standard for measuring large cap U.S. stock market performance and includes a representative sample of leading companies in leading industries.

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