Bear Market

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What is a Bear Market

A bear market is a condition in which securities prices fall 20 percent or more from recent highs amid widespread pessimism and negative investor sentiment. Typically, bear markets are associated with declines in an overall market or index like the S&P 500, but individual securities or commodities can be considered to be in a bear market if they experience a decline of 20 percent or more over a sustained period of time - typically two months or more. The U.S. major market indexes fell into bear market territory on December 24th, 2018. The last bear market in the U.S. occurred between 2007 and 2009 during The Financial Crisis and lasted for roughly 17 months. The S&P 500 lost 50 percent of its value during that time.

Secular and Cyclical Bear Markets

Bear markets can last for multiple years or just several weeks. A secular bear market can last anywhere from 10 to 20 years, and is characterized by below average returns on a sustained basis. There may be rallies within secular bear markets where stocks or indexes rally for a period of time, but the gains are not sustained, and prices revert to lower levels. A cyclical bear market can last anywhere from a few weeks to several years.

Bear vs. Bull

The term “bear market” is the opposite of a “bull market,” or a market in which prices for securities are rising or will expect to rise. It is named for the way in which a bear attacks its prey — swiping its paws downward. This is why markets with falling stock prices are called bear markets. Just like the bear market, the bull market is named after the way in which the bull attacks by thrusting its horns up into the air.

What Causes a Bear Market?

The causes of a bear market often vary, but in general, a weak or slowing or sluggish economy will bring with it a bear market. The signs of a weak or slowing economy are typically low employment, low disposable income, weak productivity and a drop in business profits. In addition, any intervention by the government in the economy can also trigger a bear market. For example, changes in the tax rate or in the federal funds rate can lead to a bear market. Similarly, a drop in investor confidence may also signal the onset of a bear market. When investors believe something is about to happen, they will take action — in this case, selling off shares to avoid losses.

Phases of a Bear Market

Bear markets usually have four different phases. The first shows high prices and high investor sentiment. But in this phase, investors are beginning to drop out of the markets and take in profits. In the second phase, stock prices begin to fall sharply, trading activity and corporate profits begin to drop, and economic indicators that may have once been positive start to become below average. Some investors begin to panic as sentiment starts to fall. This is referred to as capitulation. The third phase shows speculators start to enter the market, therefore raising some prices and trading volume. In the fourth and last phase, stock prices continue to drop, but slowly. As low prices and good news starts to attract investors again, bear markets start to lead to bull markets.

Bear Market vs. Correction

A bear market should not be confused with a correction, which is a short-term trend that has a duration of fewer than two months. While corrections offer a good time for value investors to find an entry point into stock markets, bear markets rarely provide suitable points of entry. This is because it is almost impossible to determine a bear market's bottom. Trying to recoup losses can be an uphill battle, unless investors are short sellers or use other strategies to make gains in falling markets. Between 1900 and 2015, there were 32 bear markets, averaging one every 3.5 years. The last bear market coincided with the global financial crisis occurring between October 2007 and March 2009, during which time the DJIA declined 54 percent during the period.