Active Insights Podcast – Brad Thompson's Perspective on the History of Bear Markets

Diane Merritt:

Welcome to North Square Investments Active Insights Podcast. North Square Investments is dedicated to bringing differentiated, active investment strategies to financial advisors and investors through our multi-boutique asset management platform. Today, Mark Goodwin, Chief Executive Officer of North Square Investments will focus on the current market environment and discuss bear markets with Brad Thompson, Portfolio Manager and Director of Multi-Asset Class Solutions with CS McKee. CS McKee is a partner firm in the North Square platform.

Mark and Brad, we look forward to your discussion.

Mark Goodwin:

Thanks, Diane. As you mentioned, at North Square we seek out best-in-class* active managers for our platform, and Brad's expertise in multi-asset and risk-managed alternative strategies provides a great perspective on managing through a difficult market climate.

Brad, you and your team manage three distinct strategies for us with a common thread of managing risk and volatility. We've seen some pretty dramatic shifts in markets over recent months, mostly on the downside. What's the state of the market now? And do you think we're in or at the start of a bear market?

Brad Thompson:

Well, Mark, it depends on which index you look at, right? But the Nasdaq (Composite) certainly is in a bear market. It's in bear market territory and has been for a couple of weeks. We have not reached bear market territory in the S&P and the Dow Jones. So the jury's still out a little bit on that one, but it feels like we could be in the early stages of a bear market, yes.

Mark Goodwin:

We went through a bear market with a "dotcom" bubble in 2000 and the Global Financial Crisis in 2007. Can you tell us about the broader history of bear markets? How deep do they go and how long do they typically last?

Brad Thompson:

Yes, sure. So, and again, it depends on which index you're looking at because they all have slight differences, but they are correlated, so the statistics are fairly similar. If you look at the S&P 500, going back to the 1920s, we've had 21 bear markets, so that's an average of about one every four-and-a-half years, which seems a lot more frequent than most people realize, but they tend to cluster together, right?

So in the ‘30s, we had multiple bear markets. In the ‘40s, we had multiple bear markets. Fifties, we had a couple. Sixties, we had a couple. Then there's some decades where you don't have any, right? So the 1990s, we didn't have any bear markets. The decade of the 2000s was one where we had two bear markets, but it was followed by the decade of 2010 where we didn't have any, right?

So when I say average, it just depends on kind of which decade you're in, but they average about a 35, 37% decline. Some are much larger, right? Some of them, 70, 80% declines. You have some that cluster around 50%, and then there's some that barely reach bear market territory, which is the official 20%-range. But they average around a year to a year-and-a-half in length in terms of bear market, and it takes about 40 to 60 months to get back to even. Again, depending on which index you're looking at and which group of bear markets you're including in the statistics, but they're usually broad ranged and long term.

But the one that pops out on the list to me is the most recent bear market, which was the COVID crash, right? It was a very rapid bear market. It basically only lasted one month, and we recovered in a very short time period. So if investors opened their statement at the end of the year, and they saw their beginning balance and their ending balance, you wouldn't even notice there was a bear market in the middle. So that one did not cause the corrective action that most bear markets usually employ into the markets, but most bear markets will change investor behavior. They will change investor's mindsets. They will change risk appetites. And the COVID crash really didn't do that because it was so rapid. So the next bear market may be more painful and may be broader in the teeth, so to speak, and last a little bit longer than that one did.

Mark Goodwin:

Thank you, Brad. Good insights. We're coming off a highly accommodative interest rate environment where rates were at historic lows. Now that's shifting with an accompaniment of quantitative tightening as the Fed unwinds its balance sheet. How do you see the direction and level of aggressiveness of Fed policy impacting the way this plays out in the markets?

Brad Thompson:

Well, it kind of goes back to the statistics I mentioned earlier, right? So you have some decades where you have clusters of bear markets and others where you don't have any. Well, we just came out of one where we didn't have any, right? From 2009 to the COVID crash, we had no bear markets during that timeframe, and that's because we had the Fed put, right? The Fed was pumping money into the economy, liquidity into the economy, and really forcing investors into “risk” assets. Well, it's just the opposite now, right? So the Fed is tapering. They're becoming much more hawkish. And so over the next 5 to 10 years, you might expect to see the frequency of bear markets actually increase, and we may have one of those decades where we have multiple bear markets.

Mark Goodwin:

Brad, in reviewing past bear markets, you spoke about “head-fake” rallies occurring over the course for a broader downturn. How do you determine when the market is bottoming out versus getting caught in a head-fake rally?

Brad Thompson:

Well, we have a process that we use where we use technical measures and, of course, none of them are always a hundred percent accurate, but it kind of gives us a read on sentiment and price trends and breadth that are in the market that kind of give us an idea of when we might see strength re-entering the market, but the head-fake rallies can still happen. I mean, if you go back and look at some of the historical markets, they definitely occur, and they could be very, very painful for investors because it looks like the bear market's over when in fact it's not.

Mark Goodwin:

Right. For some time now, passive investments have gained popularity among investors. How important is active management in an environment like we're experiencing today?

Brad Thompson:

Well, I think it's increasingly more important because of the volatility, right? And volatility management is very important in the portfolio. So if you think about environments where it's difficult to manage through, a passive strategy is good, right? When everything is going up, and you're never going to underperform the benchmark, right? But if that benchmark is down 50%, you better be prepared to ride down with it, and that's where active management can come in and reduce volatility within the portfolio and reduce some of that downside risk.

Mark Goodwin:

Are there areas or sectors where you're finding opportunities in this current environment?

Brad Thompson:

Well, yes certainly. We actually have recently moved to some inverse positions because of the weakness in the markets, but it's difficult. Right now, bonds are struggling, stocks are struggling, but there are some pockets where we've had some areas where we've seen some success, some countries where energy and resources are abundant have been favorable.

Mark Goodwin:

Brad, this is probably the first time some younger investors are experiencing this severity of downturn, and you have been trained to buy the dips. So we'll have to see if that continues to play out as a good strategy. How would you think investors should be looking to position themselves now, and what type of investment strategies should they be considering given the backdrop of uncertainty?

Brad Thompson:

Well, obviously managing defensive strategies I have a tendency to think that now is the time for those. I think that if you employ, at least for part of your portfolio, strategies that can become defensive when things get very scary, it can serve well for you. But these strategies can also make money when the market trends reverse and turn back up again. So, I mean, I think that it's a good idea to employ some sort of active management and defensive posture within the portfolio.

Mark Goodwin:

With the equity markets down significantly from the highs of a few months ago, do you think it's too late for people to be shifting a portfolio to navigate this type of market, or is it exactly the right time to think about it?

Brad Thompson:

Yes. I mean, there's no perfect timing to do that, and it's going to be different for every individual, but I mean, I think if you're looking at investing over the next 5 to 10 years, it makes a lot of sense to employ some sort of defensive mechanism within the portfolio.

Mark Goodwin:

Brad, thank you for joining me today. This has been a great discussion as always.

Brad Thompson:

Absolutely. Thank you, Mark.

Diane Merritt:

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Definitions of terms used in this podcast:

A **bear market** is when a market experiences prolonged price declines. It typically describes a condition in which securities prices fall 20% or more from their recent highs amid widespread pessimism and negative investor sentiment.

The **Nasdaq Composite** is a stock market index that includes almost all stocks listed on the Nasdaq stock exchange. Along with the Dow Jones Industrial Average and S&P 500, it is one of the three most-followed stock market indices in the United States.

The **Standard and Poor's 500**, or simply the S&P 500, is a stock market index tracking the performance of 500 large companies listed on stock exchanges in the United States. It is one of the most commonly followed equity indices.

The **Dow Jones Industrial Average**, or simply the Dow Jones, is a price-weighted measurement stock market index of 30 prominent companies listed on stock exchanges in the United States.

A **risk asset** is any asset that carries a degree of risk. Risk asset generally refers to assets that have a significant degree of price volatility, such as equities, commodities, high-yield bonds, real estate, and currencies.

Tapering is how the Federal Reserve reverses economic stimulus by slowing the pace of its asset purchases. The Fed began to taper its current bond-buying program in November 2021. Tapering is a controlled way to phase out quantitative easing while managing the continued economic recovery.

A "**head-fake**" rally gets its name from a tactic commonly used by a basketball or football player to throw the opposition off, by leading with their head to pretend that they are moving in one direction but then move in the opposite direction.