How to Survive a Bear Attack: The Story of Brutal Bears and Tamable Cubs

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When should you run from a bear, and when should you stand your ground? Not large mammals, but the dreaded bear markets. While an actual bear can kill you, a bear market can ruin your finances with one terrible swipe! Here's how to protect yourself from these terrible financial creatures.

The broadly accepted definition of a bear market is a 20% or more decline in stock prices from a peak. Although fear can cloud the mind when it comes to making rational investment decisions, the answer to the question I posed at the outset is simple: Run from recessionary bears and stand your ground against others. As this great bull market continues its historic run, many are turning concerned eyes to the future, the yield curve, economic data or anything to try to get an edge one when to exit the stock market before the next bear market and recession. Getting out before a bear market strikes can save a lot of pain, maintain your wealth and will give you plenty of cash to buy back in to the market at better prices.

After studying the S&P 500 going back to 1950s, I found that there are two distinct types of bear markets: traditional bear markets and bear cubs. The former are the brutal kind we all fear – bear markets that occur during an economic recession. Those bear markets are long, painful, and severally damage one's financial condition as they tend to lead to emotionally-driven and counterproductive investment decisions. Going back to 1957, there have been six of these traditional recessionary bear markets that lasted on average 20 months, took four years and seven months to break even and lost -39.8% from the market peak to its trough.

The other bear markets, the ones you should firmly stand your ground against, are the down markets that occur outside of an economic recession. Those are what I call "bear cubs." They are still bitterly painful to endure, but do not give a good reason to sell and abandon the stock market. Those markets are made back in relatively much shorter amount of time. In the same study noted above, I found three non-recessionary bear cub markets in the S&P 500 that lasted on average six months, took one year and seven months to break even, and lost -27.9% from peak to trough.

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To recap:

	Traditional Bear	**Bear Cub**
Occurrence	During Recession	Outside of Recession
Average Duration	24 Months	6 Months
Average Time to Break Even	4 Years and 7 Months	1 Year and 7 Months
Average S&P 500 Loss	-39.8%	-27.9%

S&P 500 data sourced from Yahoo! Finance. Performance statistics are exclusive of dividends.

The difference between these two types of bear markets is apparent and stark. The duration of traditional bear markets is approximately 3 and a half times longer than bear cubs, takes over 2 and a quarter times longer to break even, and is just shy of one and a half times more severe in losses.

Stock market investors should avoid staying invested during traditional bear markets and ride it out during bear cubs.

That begs the next question: How do you know if you're staring down an ugly and fearsome traditional bear or a more tamable bear cub? Investors have been hyper-focused on the yield curve lately looking for signals of an upcoming recession. Specifically, I was hunting for the dreaded yield-curve inversion. A yield-curve inversion, as measured when the two-year Treasury yields more than the 10-year Treasury, has occurred ahead of every economic recession in the last four decades.

Using data from the Federal Reserve Bank of St. Louis dating back to 1976, I ascertained how the yield curve historically behaved relative to the stock market. In that timeframe, there were four total bear markets – three traditional and one bear cub. Every one of the traditional bear markets was associated with a yield-curve inversion. The bear cub, conversely, was not. This further suggests in the absence of a yield-curve inversion, investors should stay the course during troubled markets that are non-recessionary.

This is not a call to time the market. It's nearly impossible to get out at the top of the market and even harder to repeat that feat.

This is a call, however, to monitor your investments ever more closely as we approach the feared yield-curve inversion. It is highly likely the yield curve will invert in 2019, giving investors their first warning of the impending traditional bear market. This will be the first yield-curve inversion since the Great Recession and a strong signal to start creating a defensive plan for your investments.

Until then, have the courage to stay invested. When the economy is doing well and the yield curve hasn't inverted, don't be scared out of the markets by bear cubs.

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