Corrections Almost Always Test Lows Before They Are Complete

February 15, 2018

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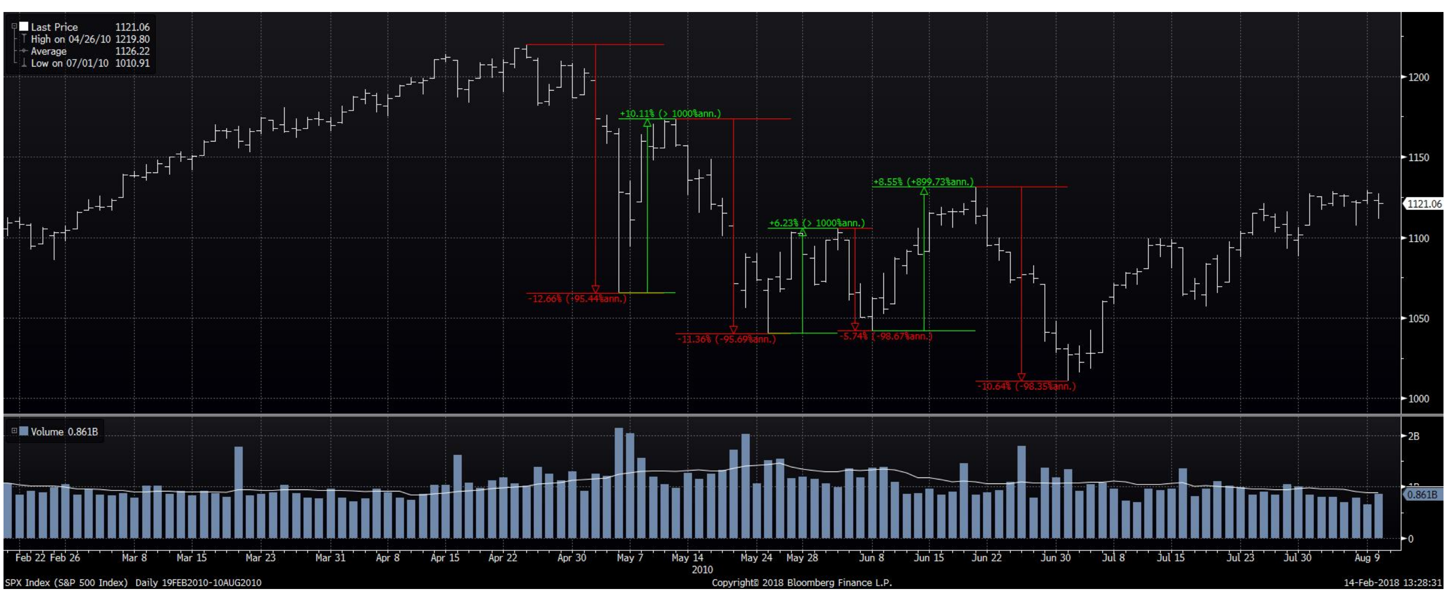
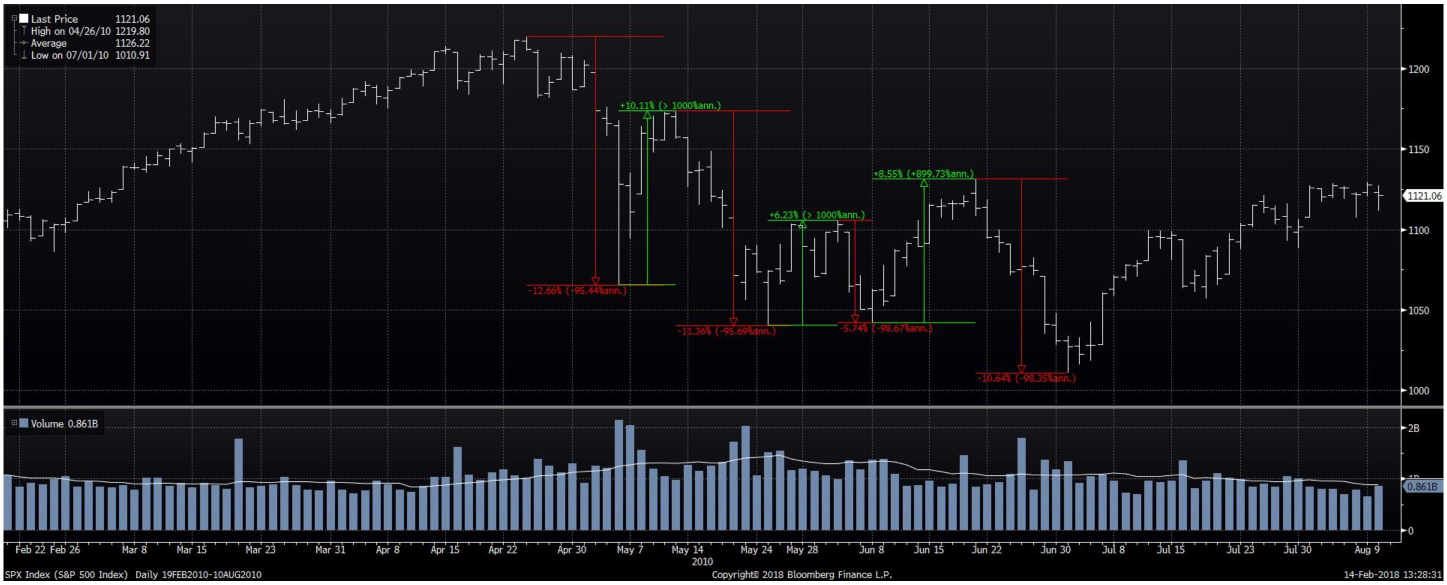
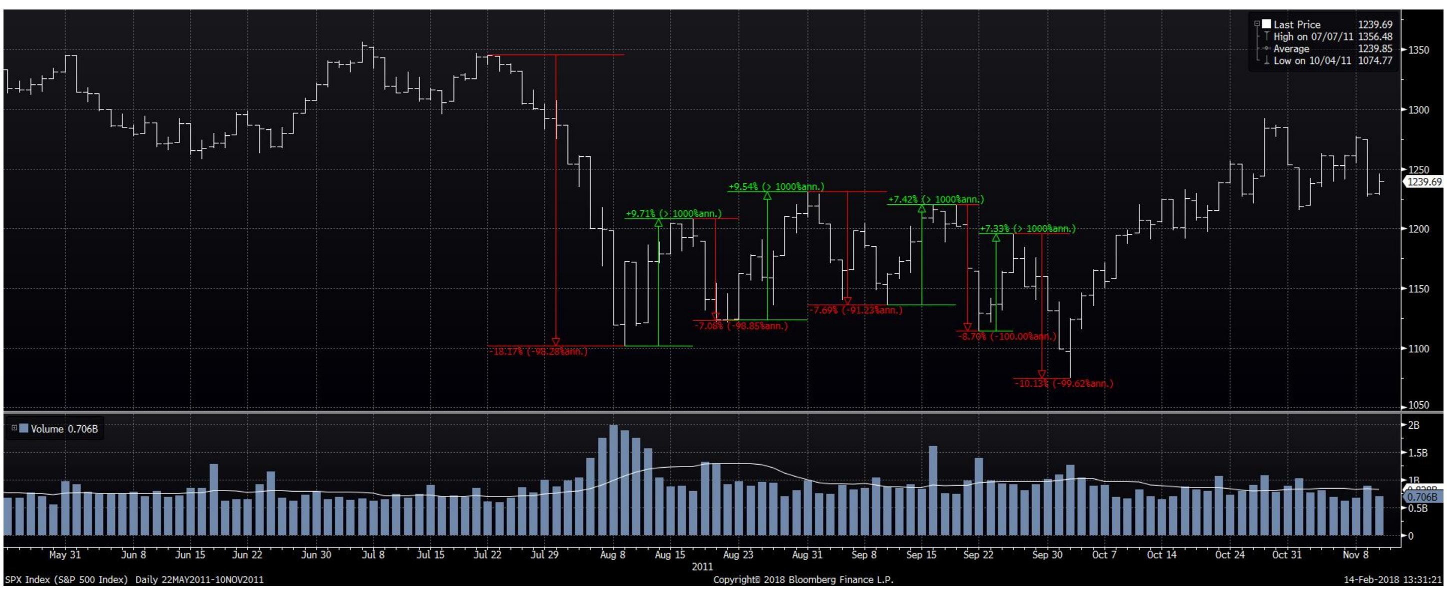
As we navigate a period of market turmoil, its important to remember that non-bear corrective phases typically last six weeks to two months and almost always include several several substantial large rallies followed by selloffs back to the range of the initial low. Indeed, this classic give and take is how important bottoms are usually formed. From a psychological standpoint, we can think of it as the weak hands exiting on strength (perhaps at or about the level at which they bought in) and strong hands stepping in on weakness. In this post we examine the past four major S&P 500 drawdowns (2010, 2011, 2012 and 2015-2016) to demonstrate the bottoming process that is typical of market corrections. We apologize ahead of time for the larger than normal charts.

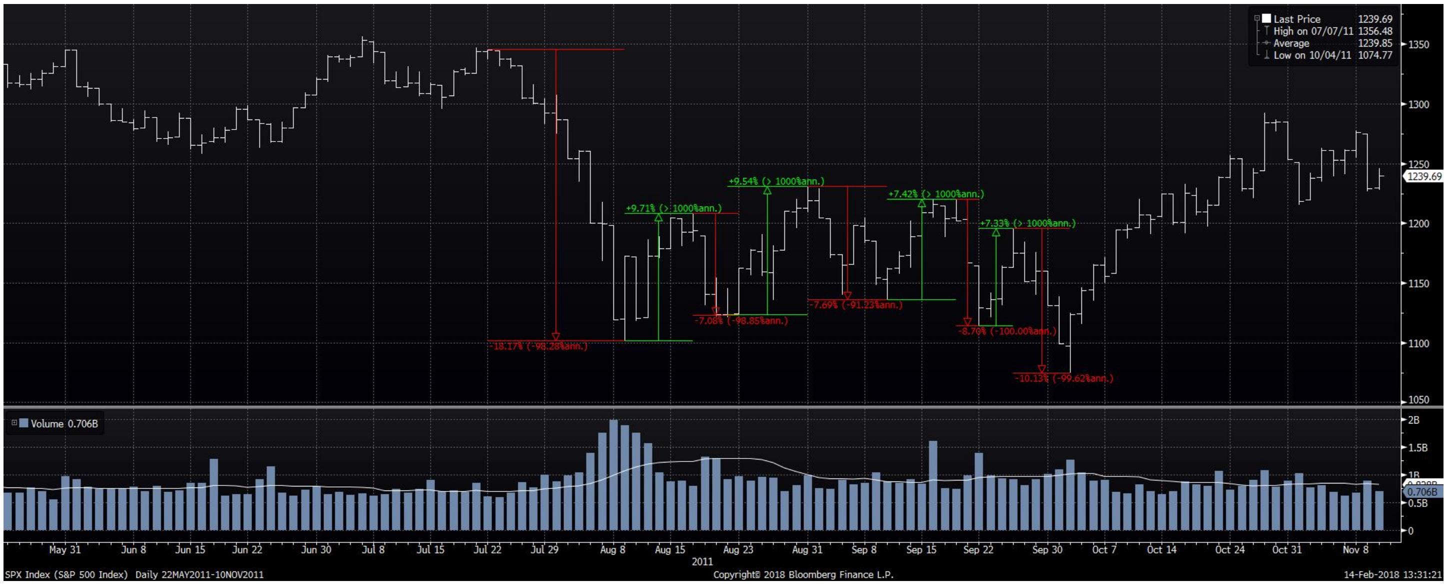
Starting with the 2010 correction, we see that an initial 12% selloff over two weeks was followed by a 10% rally over five days to old highs, another 11% decline, two more rally attempts, and then a final 11% plunge. The whole episode lasted about two months.



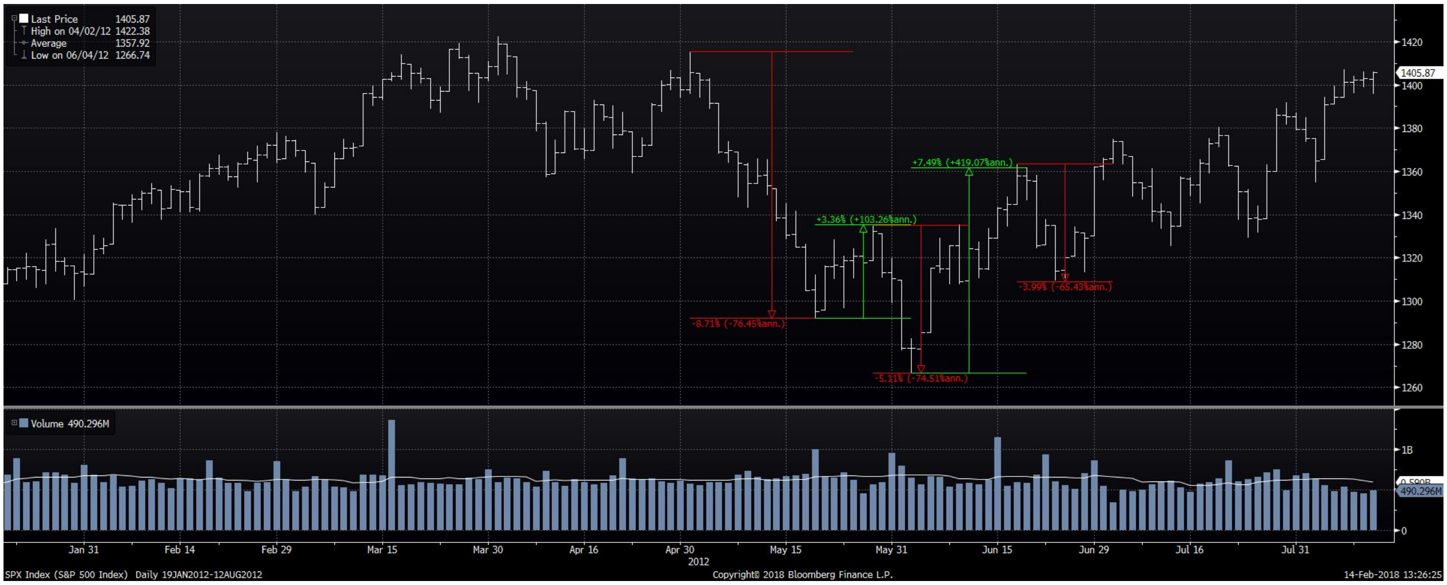


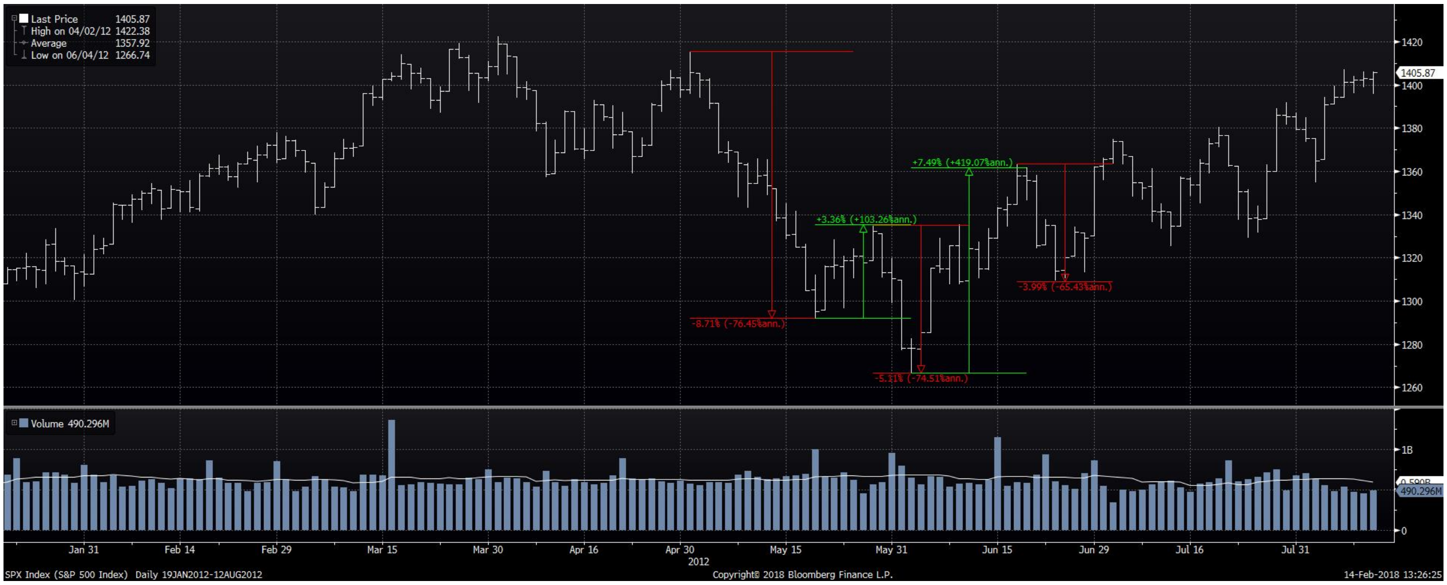
During the 2011 correction, an initial two weeks of weakness that took the market down 18% was followed by four substantial attempts to rally to the previous highs and then a final 10% dump into the ultimate low. The whole episode lasted about two months.



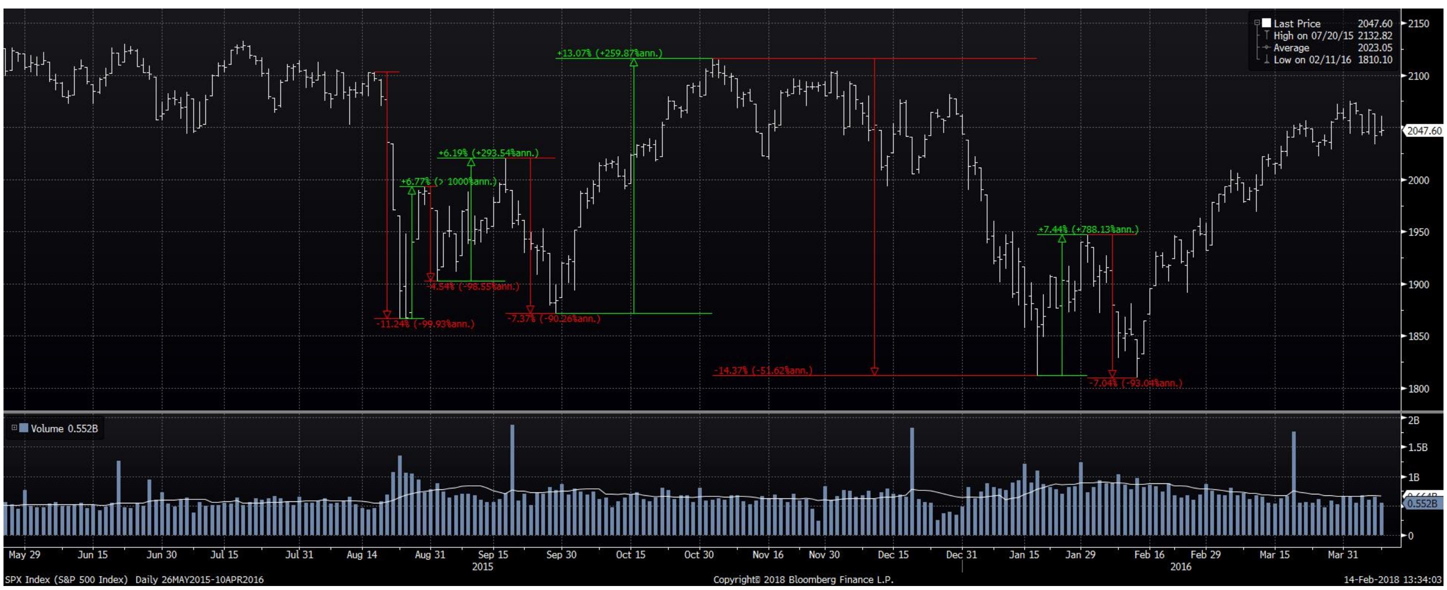


In the 2012 correction, a 9% initial selloff over two weeks was followed by a 3% rally lasting five days and a final 5% dip over four days into the low. That ultimate low was then retested two weeks later with a 4% dip. The whole episode lasted two months.





During the 2015-2016 correction, the market dropped 11% over three days, made two vigorous attempts at the old highs, and then fell another 7% to test the initial low. But the correction wasn't over. The market rallied a full 13% to the range of the previous highs, stayed there for six weeks and then fell 14% to a new, lower low. This new low was followed by a 7% rally and an 8% final plunge into the ultimate low. The whole episode lasted six months with the initial phase lasting six weeks.



Finally, we show the current correction in real time. We see that the market plunged 10% over seven days, rallied 5% over two days, and then made a new low two days hence. We've since rallied back nearly 7% over four days to exactly the 65-day moving average. The whole episode has lasted thirteen days, with the low achieved after ten days. Given the above episodes, and many others like them throughout market history, it would be completely normal and indeed expected for this market to test the low put in place on Friday, February 9th one or several more times, and possibly break that level. It would be normal for this back and forth process to take place over the next four to six weeks.

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