

Enjoy the Rally, But Prepare for the Retreat

Investors may be lulled into a false sense of security by this market.

Provided by Edward Grondahl

Will the current bull market run for another year? How about another two or three years? Some investors will confidently say “yes” to both questions. Optimism abounds on Wall Street: the major indices climb more than they retreat, and they have attained new peaks. On average, the S&P 500 has gained nearly 15% a year for the past eight years.¹

Stocks will correct at some point. A bear market could even emerge. Is your investment portfolio ready for either kind of event?

It may not be. Your portfolio could be overweighted in stocks – that is, a higher percentage of your invested assets may be held in equities than what your investment strategy outlines. As your stock market exposure grows greater and greater, the less diversified your portfolio becomes, and the more stock market risk you assume.

You know diversification is important, especially when one investment sector that has done well for you suddenly turns sideways or plummets. When a bull market becomes as celebratory as this one, that lesson risks being lost.

How do bear markets begin? They seldom arrive abruptly, but some telltale signs may hint that one is ahead. Notable declines or disappointments in corporate profits and quickly rising interest rates are but two potential indicators. If the pace of tightening speeds up at the Federal Reserve, borrowing costs will climb not only for households, but also for big businesses. A pervasive bullishness – irrational exuberance, by some definitions – that helps to send the CBOE VIX down to unusual lows could be seen as another indicator.

How long could the next bear market last? It is impossible to say, but we do know that the longest bear market on record lasted 929 days (calendar days, not trading days). That was the 2000-02 bear. A typical bear market lasts 9-14 months.^{1,2}

Enjoy this record-setting Wall Street run, but be pragmatic. Equities do have bad years, and bears do come out of hibernation from time to time. Patience and adequate diversification may make a downturn more tolerable for you. You certainly do not want the value of your portfolio to fall drastically in the years preceding your retirement, when you will have a narrow window of time to try and recoup that loss. Remember, the market does not always advance.

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Citations.

1 - cnbc.com/2017/09/19/what-investors-should-do-before-the-bull-market-gets-gored.html [9/19/17]

2 - investopedia.com/news/how-do-bear-markets-start/ [10/14/16]