Requirements for a Bear Market

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With the carnage in stocks continuing, many have been asking, "Is this another 2008?"

In 2008 and 2009 investors experienced the worst bear market since the Great Depression. And, justifiably, everyone would like to skip the next one. Bear markets have always coincided with one or more of the following:

1. A spike in crude oil prices
2. A spike in interest rates
3. An economic recession

In 2008, the price of West Texas Intermediate (WTI) crude oil shot up from $87 per barrel on February 6, 2008 to $145 per barrel on July 3, 2008. In addition, the U.S. economy suffered what is now referred to as the "Great Recession" from December 2007 to June 2009.

We have already met the technical definition of a correction (a price decline of at least 10% of any market index) in the current market sell-off. The S&P 500 declined more than 12% from May 20, 2015 to August 25, 2015, with downside volatility accelerating in August. Market volatility is continuing into September, and some are wondering whether stocks will recover soon, or are we entering the next bear market. So, let's consider the requirements for a bear market.

1. Crude oil has been in a bear market of its own, falling from $108 per barrel for WTI crude oil in June of 2014 to below $40 recently. Crude rallied more than 27% in three days on an announcement by the Saudis that they would meet with other countries to discuss a "fair price" for oil. However, the rally faded. With U.S. frackers now the marginal producers of oil, it is hard to see a spike in oil prices anytime soon. In fact, we believe WTI crude prices will remain low ($30 to $65) for quite a long time.

2. Anxiety over the first Fed rate hike in nine years has certainly been a contributor to stock market volatility. But, even when the Fed finally embarks on tighter monetary policy, the trajectory will be slow and steady. Additionally, the long end of the yield curve may not move much at all. Sovereign bonds in Europe and Japan are at ultra low yields that will last for some time, as they continue easing monetary policy. We see no spike in interest rates on the horizon.

3. In our recent communication on the markets, we discussed the strength of the U.S. economy. Business lending is at an all-time high. Housing is growing at the strongest pace since 2007. Jobless claims are running at the lowest rate in 41 years. Consumer confidence is at the highest rate in years. August auto sales were at the highest annualized run rate in 10 years. And, second quarter GDP was just revised to 3.7% growth. These economic indicators are hardly pointing to a U.S. recession.

Liquid alternative investments, utilized within our Tactical Asset Allocation investment process, have continued to mitigate downside volatility in our IRA and non-retirement accounts. In fact, the tactical moves we made preceding the current market correction, reduced the standard deviation (volatility) of our growth portfolios relative to the S&P 500 Index by as much as a third, compared to our risk level in the first seven months of the year.

Market timing is a losing game. However, Tactical Asset Allocation, which includes opportunistic positions in alternative investments with low or negative correlation to stocks, provides diversification, downside protection, and a fully invested portfolio to weather up and down markets with the potential for significant risk-adjusted total returns.

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