Remembering bear markets past

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Guy Foster, our Head of Research, reflects on the last two bear markets and the lessons they provide for investors today

We are now suffering the third bear market in the last twenty years. The first two came in relatively quick succession in 2000 and 2008. Since then we have been blessed by a decade of generally healthy returns before this latest bear market has arisen. There are many of us here who have invested through these three, and other, challenging episodes.

"History doesn't repeat but it rhymes" said Mark Twain and so the lessons of the past can inform our understanding of the future. Bear markets come in various forms. The bursting of the technology bubble was an arduous slog. The global financial crisis was sharper. This current response to the emergence of the coronavirus has been sharper still.

As we have commented before, it reflects not the health concerns but the economic impact of efforts to contain or delay the spread of the virus. Those measures should be temporary and that economic shock should pass. Some investors have shorter, or longer-term, outlooks but companies will be valued not just based upon next year's profits or dividends, but on the basis of the flow of profits or dividends into the future. It would be convenient if each company's profits grew year after year in the same way that interest on deposits compound (or used to). We even try to seek out these qualities in the companies that we invest in. But from time to time most company profits will decline for any number of reasons. As long as those reasons are temporary, then investors needn't fear much change in the company's value.

Hence the market impact of such declines should be limited and does not justify truly extreme declines like those seen on Thursday 12 March. Those falls had definite echoes of the financial crisis and reflect concerns within the market that what could be a temporary hit to economic activity might become more severe and longer lasting. The concerns investors would have in that regard would be that companies suffering a temporary hit to sales might need to shed some staff or find it difficult to repay their debt. These are the conditions which could turn a short-term downturn into a longer vicious recessionary cycle.

Even after ten years it is natural for investors to look at the events of 2008 and fear them being reprised. Some of these circumstances are the same but some are different. For one thing the very specific over-leverage of the banking system has been systematically corrected by policymakers. We can also observe that policymakers themselves recognise the folly of allowing a bank to go bust and we can assume that through both proactive and reactive measures a major bank failure will not be allowed to happen again.

At the time of the financial crisis, central banks worked on the basis that they could cut interest rates in order to support the economy. They rapidly expanded their arsenal to include such wonders as quantitative easing and various other measures involving the printing of new money. The expanded unconventional toolkit of central banks is the counterpoint to its diminished potential to lower interest rates much further. Nonetheless, one policy maker's chalk is another's cheese as lower interest rates give governments more ability to spend to support the economy at very little cost (in some cases negative cost) for the next few years.

In this case the flesh is strong but is the spirit willing? It should be. There was reticence at using extraordinary monetary measures during the financial crisis as it was perceived to rescue consumers and businesses which

had caused the crisis by borrowing irresponsibly. People worried about the moral hazard of such a bailout.
No such concerns exist today. Rather than a moral hazard, policymakers are facing a moral duty to protect businesses and consumers against something they could not have foreseen.

Perhaps the most important experience gained from bear markets past is that they do end. We have invested through each of them, taking the opportunities they provide and using it to enhance our clients' wealth.

Speaking entirely personally, I have had the dubious pleasure of working and investing through two severe bear markets. They are not pleasant experiences and yet I have no regrets because the *ends* of growing wealth have been justified by the *means* of enduring some risk.

Guy Foster, Head of Research

Guy leads Brewin Dolphin's Research team, providing recommendations on tactical investment strategy to Brewin Dolphin's investment managers and strategic recommendations to the group's Asset Allocation Committee. He is a CFA charterholder, holds the CISI Diploma, and is a member of the Society of Business Economists. Guy frequently discusses financial issues with the written and televised media as well as presenting to the staff and clients of Brewin Dolphin.

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