



Putting the 2015 Stock Market Pullbacks in Perspective

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We can gain perspective by considering post-World War II declines in the S&P 500® Index. When we do, we see that the majority of declines fall within the 5-10% range with an average recovery time of approximately one month. Declines between 10-20% occurred about every three years with an average recovery period of approximately three months. Pullbacks within these ranges are not uncommon, occurring frequently during the normal market cycle. While they can be emotionally unnerving, they will not generally undermine the well-diversified portfolios that we create for our clients. These pullbacks are not signals for panic. Even more severe pullbacks of 20-40% registered an average recovery of only 14 months.

Declines in the S&P 500 Since 12/31/1945

Decline %	# of Declines	Avg Decline %	Avg Length of decline in Months	Average time to Recover in Months
5-10%	75	-6	1	1
10-20%	25	-13	4	3
20-40%	8	-27	11	14
40+%	3	-51	22	57

In contrast, pullbacks of 40% or more, while occurring much less frequently, post an average recovery time of 57 months and can potentially compromise an investor’s financial plan if stock investments have a time horizon of less than 5 years.

Do severe market pullbacks, which are typically followed by long recovery periods, share anything in common? The answer is that those pullbacks above 20% (including all pullbacks above 40%), which have registered the longest recovery periods, have been associated with economic recessions. So, when evaluating a potential market pullback, the probability of a recession is a key insight to consider when evaluating the expected recovery time.

Where are we now?

A close look at the economic and market data tells us that we are not entering a recession, nor are we even near a recession in the United States. Markets over the last few weeks have taken investors on the equivalent of an amusement park ride—we’ve gone up, down and sideways, and in some cases, upside down, and we are left feeling dizzy. Since 1962, recessions have invariably been preceded by a year-over-year decline in Leading Economic Indicators (LEI) readings (although not every year-over-year contraction in LEI results in a recession). The 12-month growth in LEI has been on a strong uptrend since March 2013 and, in fact, has not registered a monthly decline since January 2014. Historically, non-recessionary pullbacks have not exhibited the largest drawdowns or longest periods of recovery. The majority of pullbacks during non-recessionary periods registered declines under 20%. Pullbacks falling within the 5%-20% range historically experience recovery periods of one to three months. The most recent episode was August-October 2011.

Conclusion

Rather than act on emotion, it’s important to put these events of the summer of 2015 in the context of your long-term financial plan. If the thoughts of the 2008-2009 decline in the stock market of 40+% still linger in your mind, recognize that money invested in stocks should have a minimum of a 5 year time horizon to allow for the full recovery of your investment. Our financial plans are conservatively structured to give stocks a 7-10 year time horizon. This means that a plan is already in place to deal with even the most extreme pullbacks in the stock market. Given the condition of the economy, it is reasonable to expect that in 90 days this too shall pass and our rebalancing discipline will have allowed us to take advantage of this pullback as a buying opportunity for stocks.