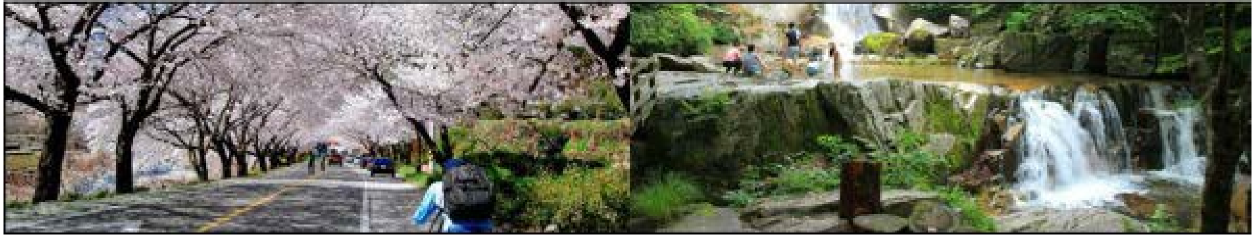

FINANCIAL PERSPECTIVES

Downturns and Recoveries

February 24, 2022

The attached documents are a reprint of our April 16, 2020 postings. All data are thru the year-end 2019.

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Market Downturns and Recoveries

1926–2019

Downturn	% Loss	Downturn period	Recovery period	Recovery
34 months	–83.4	Sep 1929–June 1932	July 1932–Jan 1945	151 months
6 months	–21.8	June 1946–Nov 1946	Dec 1946–Oct 1949	35 months
7 months	–10.2	Aug 1956–Feb 1957	March 1957–July 1957	5 months
5 months	–15.0	Aug 1957–Dec 1957	Jan 1958–July 1958	7 months
6 months	–22.3	Jan 1962–June 1962	July 1962–April 1963	10 months
8 months	–15.6	Feb 1966–Sep 1966	Oct 1966–March 1967	6 months
19 months	–29.3	Dec 1968–June 1970	July 1970–March 1971	9 months
21 months	–42.6	Jan 1973–Sep 1974	Oct 1974–June 1976	21 months
14 months	–14.3	Jan 1977–Feb 1978	March 1978–July 1978	5 months
20 months	–16.5	Dec 1980–July 1982	Aug 1982–Oct 1982	3 months
3 months	–29.6	Sep 1987–Nov 1987	Dec 1987–May 1989	18 months
5 months	–14.7	June 1990–Oct 1990	Nov 1990–Feb 1991	4 months
2 months	–15.4	July 1998–Aug 1998	Sep 1998–Nov 1998	3 months
25 months	–44.7	Sep 2000–Sep 2002	Oct 2002–Oct 2006	49 months
16 months	–50.9	Nov 2007–Feb 2009	March 2009–March 2012	37 months
3 months	–13.5	Oct 2018–Dec 2018	Jan 2019–Apr 2019	4 months

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Past performance is no guarantee of future results. This is for illustrative purposes only and not indicative of any investment. An investment cannot be made directly in an index. Downturns are defined by a time period when the stock market value declined by 10% or more from its peak.

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Market Downturns and Recoveries

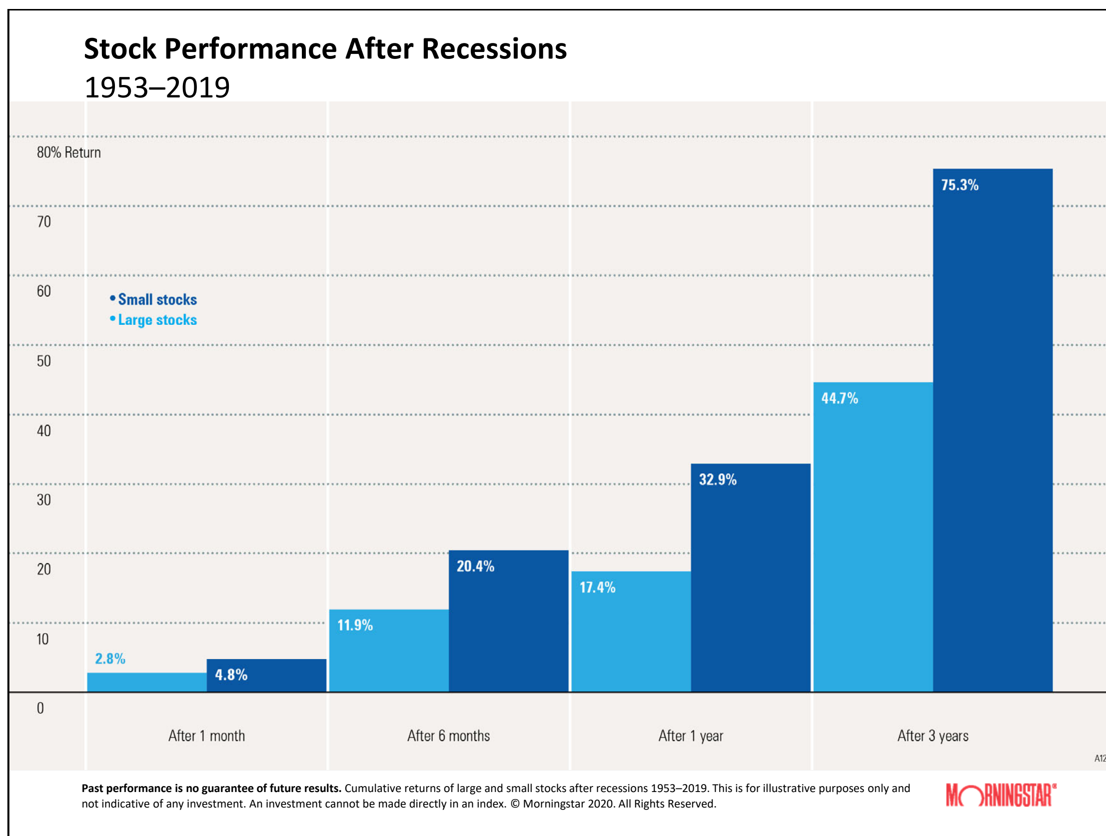
A historical account of past downturns and recoveries can present a better picture of potential market performance. There have been many U.S. equity market downturns over time, with varying levels of severity and differing lengths of recovery. The most severe downturn marked the start of the Great Depression, when stocks lost over 80% of their value. In this case, the recovery period was over 12 years. More recently, stocks lost 44.7% of their value during the early-2000s bear market. This recovery period, lasting four years, was the second-longest in history. Stocks lost 50.9% during the recent 2007–09 bear market; this downturn lasted for 16 months, and the stock market recovered after 37 months, in March 2012. It is evident that stocks are prone to sudden declines in value. These declines seem to happen at random, and there are many different reasons for stock market crashes and bear markets. Sometimes stocks recover their value quickly, while other times the decline lasts for a while.

The recovery period may be painfully long. Often, the decline is preceded by a period of high returns, which lulls investors into a false sense of security. Because no one can predict market declines with certainty, a diversified portfolio may be the best solution for a long–term investor who is concerned about both return and risk.

Returns and principal invested in stocks are not guaranteed. Diversification does not eliminate the risk of investment losses.

About the data

Large stocks are represented by the Ibbotson® Large Company Stock Index. Downturns in this example are defined by a time period when the stock market declined by 10% or more from its peak, while the recovery period indicates the number of months from the trough of the downturn to the market's previous peak. An investment cannot be made directly in an index. The data assumes reinvestment of all income and does not account for taxes or transaction costs.



Stock Performance After Recessions

History reveals that small stocks have been among the strongest performers after recessions. Many investors fear the volatility of small stocks. Their fears, however, may not justify overlooking the potential of this asset class. The image shows that, on average, the cumulative returns of small stocks outperformed those of large stocks one month, six months, one year, and three years after the end of a recession. Small stocks haven't outperformed large stocks after every recession, yet on average their potential to lead the way out of recessions is significant. Diversifying into small stocks may benefit investor portfolios, especially when the market is coming out of a recession.

Diversification does not eliminate the risk of investment losses. Stocks are not guaranteed and have been more volatile than other asset classes. Furthermore, small stocks are more volatile than large stocks and are subject to significant price fluctuations and business risks and are thinly traded.

About the data

Large stocks are represented by the Ibbotson® Large Company Stock Index. Small stocks are represented by the Ibbotson® Small Company Stock Index. An investment cannot be made directly in an index.

Recession data is from National Bureau of Economic Research. The average cumulative returns are calculated from the end of each of the 10 recessions in U.S. history since 1953. The National Bureau of Economic Research does not define a recession in terms of two consecutive quarters of decline in real gross domestic product. Rather, a recession is a recurring period of decline in total output, income, employment, and trade, usually lasting from six months to a year and marked by widespread contractions in many sectors of the economy. The data assumes reinvestment of income and does not account for taxes or transaction costs.

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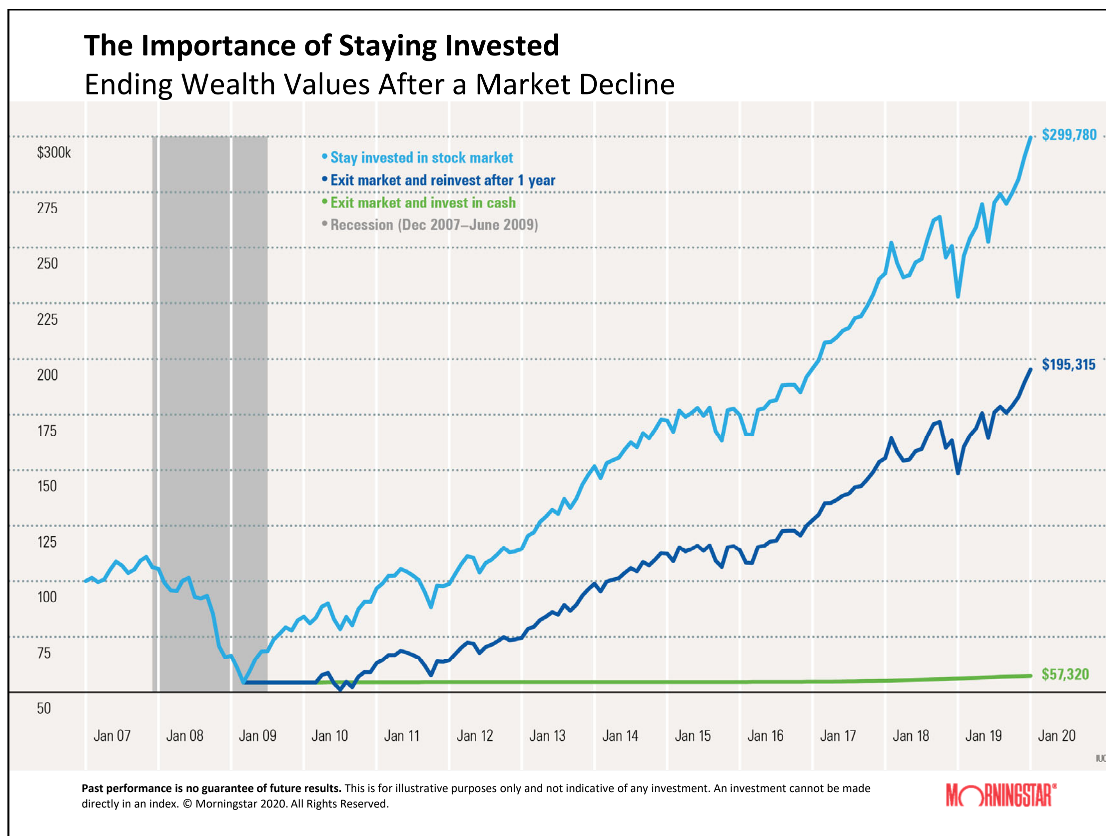

The Importance of Staying Invested
Investors who attempt to time the market run the risk of missing periods of exceptional returns, leading to significant adverse effects on the ending value of a portfolio.

The image illustrates the value of a USD 100,000 investment in the stock market during the 2007–19 period, which included the global financial crisis and the recovery that followed. The value of the investment dropped to USD 54,381 by February 2009 (the trough date), following a severe market decline. If an investor remained invested in the stock market over the next ten years, however, the ending value of the investment would have been USD 299,780. If the same investor exited the market at the bottom, invested in cash for a year, and then reinvested in the market, the ending value of the investment would have been USD 195,315. An all-cash investment at the bottom of the market would have yielded only USD 57,320. The continuous stock market investment recovered its initial value over the next three years and provided a higher ending value than the other two strategies. While all recoveries may not yield the same results, investors are well advised to stick with a long-term approach to investing.

Returns and principal invested in stocks are not guaranteed. Stocks have been more volatile than bonds or cash. Holding a portfolio of securities for the long term does not ensure a profitable outcome and investing in securities always involves risk of loss.

About the data
Recession data is from the National Bureau of Economic Research. The market is represented by the Ibbotson® Large Company Stock Index. Cash is represented by the 30-day U.S. Treasury bill. An investment cannot be made directly in an index. The data assumes reinvestment of income and does not account for taxes or transaction costs.

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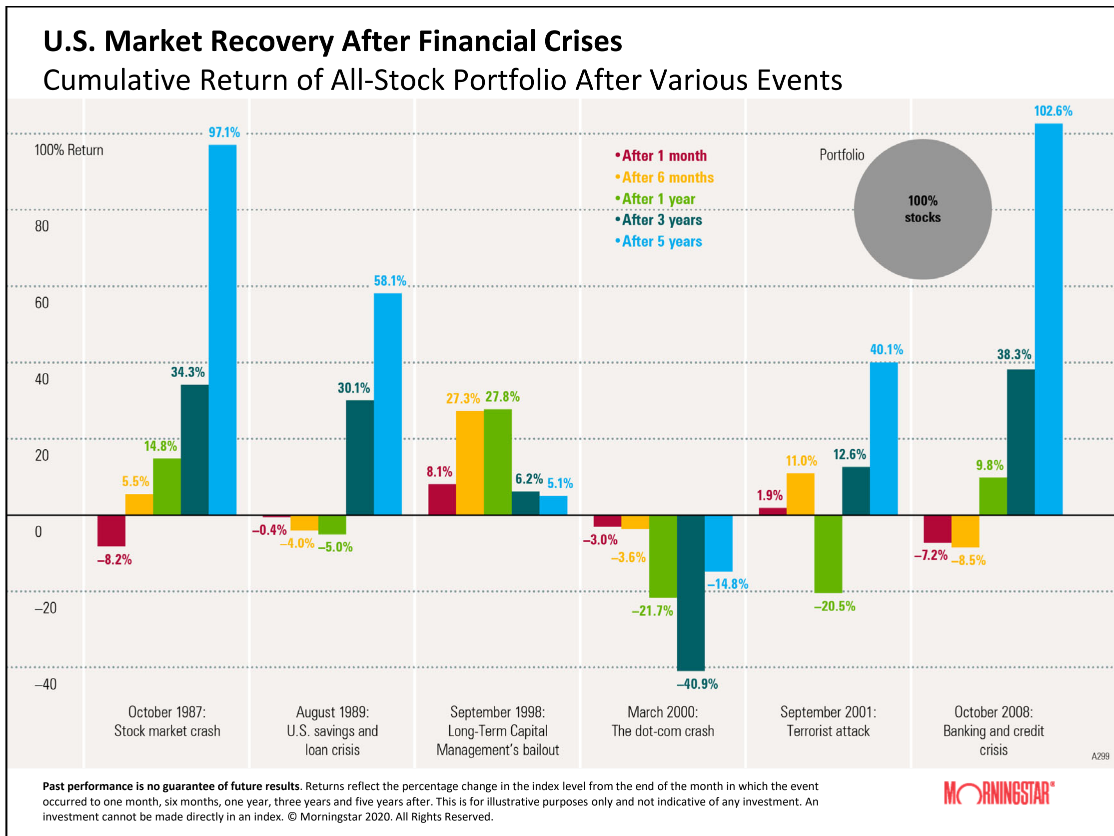

U.S. Market Recovery After Financial Crises: All-Stock Portfolio
Stock prices suffer during financial crises, but they typically recover over time.

This image illustrates the cumulative returns of an all-stock portfolio after six historical U.S. financial crises. In the short term, uncertainty from such external shocks can create sudden drops in value. For example, the all-stock portfolio posted a negative return in the month following four of the six analyzed crises. Over longer periods of time, however, returns were much more attractive, and investors who stayed the course reaped considerable rewards.

Fear and uncertainty might lead investors to sell their investments during tough times, putting downward pressure on prices. Trading because of these emotions can be detrimental to a portfolio's value. By selling during downward price pressures, investors might realize short-term losses. Furthermore, this is compounded as investors wait and hesitate to get back into the market, possibly missing some or all of the potential recovery. The lesson here is that patience can pay dividends.

Returns and principal invested in stocks are not guaranteed.

About the data
Stocks are represented by the Ibbotson® Large Company Stock Index. Calculations are based on monthly data. Data assumes reinvestment of all income and does not account for taxes or transaction costs. For the U.S. savings and loan crisis, August 1989 was chosen because that was the month the Financial Institutions Reform, Recovery and Enforcement Act of 1989 was signed into law. For Long-Term Capital Management, September 1998 was chosen because that was the month the hedge fund was bailed out by various financial institutions. For the banking and credit crisis, October 2008 was chosen because that was the month the Emergency Economic Stabilization Act was signed into law.

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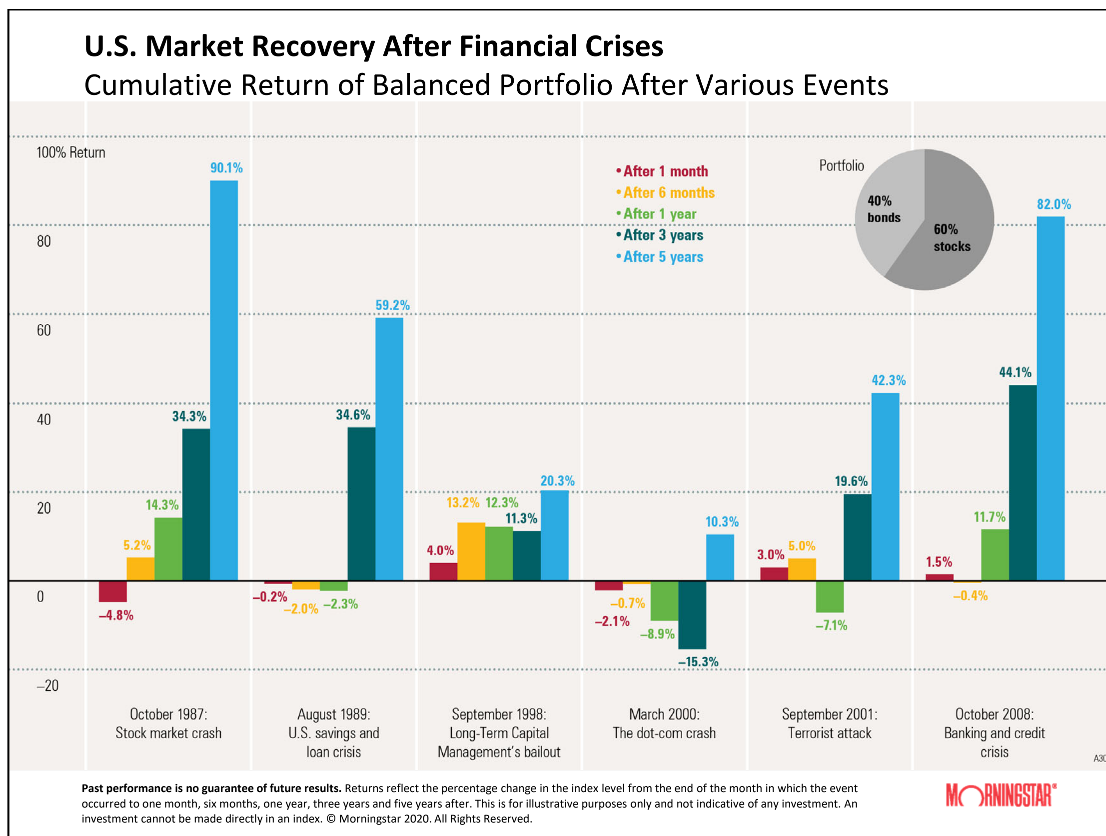

U.S. Market Recovery After Financial Crises: Balanced Portfolio
Stock prices suffer during financial crises. However, a balanced portfolio can help mitigate some of the risk.

This image illustrates the cumulative returns of a balanced (60% stock/40% bond) portfolio after six historical U.S. financial crises. In the short term, uncertainty from such external shocks can create sudden drops in value. For example, the balanced portfolio posted a negative return in the month following three of the six analyzed crises. Over longer periods of time, however, returns were much more attractive, and investors who stayed the course reaped considerable rewards.

Fear and uncertainty might lead investors to sell their investments during tough times, putting downward pressure on prices. Trading because of these emotions can be detrimental to a portfolio's value. By selling during downward price pressures, investors might realize short-term losses. Furthermore, this is compounded as investors wait and hesitate to get back into the market, possibly missing some or all of the potential recovery. The lesson here is that patience can pay dividends.

Diversification can also limit losses during turbulent market conditions. One of the main advantages of diversification is reducing risk over the long run, not necessarily increasing return. While stocks offer the potential for higher returns, the downside risk can also be extreme. A diversified portfolio can help mitigate such extreme swings in value.

Diversification does not eliminate the risk of experiencing investment losses. Government bonds are guaranteed by the full faith and credit of the U.S. government as to the timely payment of principal and interest, while returns and principal invested in stocks are not guaranteed. Stocks have been more volatile than bonds.

About the data
Stocks are represented by the Ibbotson® Large Company Stock Index. Bonds are represented by the 20-year U.S. government bond. Calculations are based on monthly data. Data assumes reinvestment of all income and does not account for taxes or transaction costs. For the U.S. savings and loan crisis, August 1989 was chosen because that was the month the Financial Institutions Reform, Recovery and Enforcement Act of 1989 was signed into law. For Long-Term Capital Management, September 1998 was chosen because that was the month the hedge fund was bailed out by various financial institutions. For the banking and credit crisis, October 2008 was chosen because that was the month the Emergency Economic Stabilization Act was signed into law.

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