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THE TRUTH ABOUT BULLS AND BEARS

If you had to guess, would you say there have been more bull markets (stretches of time the S&P 500 rose more than 20%) or bear markets (times when stock prices fell 20% or more)?

Maybe your answer depends a little on basic knowledge and a little on general confidence in capital markets. If you're a pessimist, you might think of all the downturns and resulting misery, just over the last couple of decades, and conclude stocks are a losing gamble. On the other hand, if you have faith in capitalism and know markets rise over time, you'd probably guess there have been more up markets.

Sorry, trick question. The correct answer is, going back nearly 100 years to 1926 through March of 2020, there have been 17 bear markets and 17 bull markets. Exactly the same number!

Not very encouraging, right? Market goes up and down same amount. What's the point of investing?

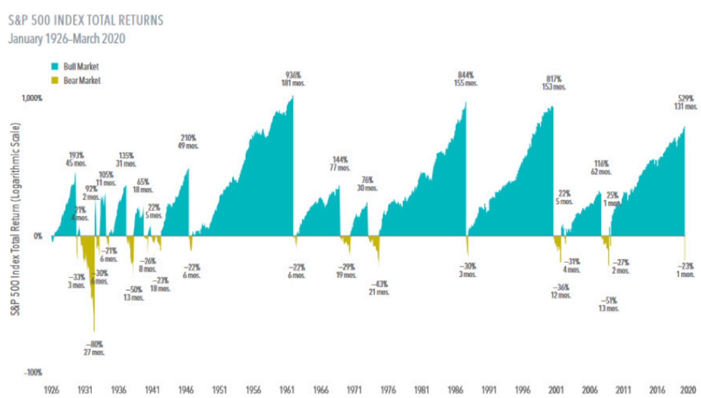
The point is the downs and the ups aren't equal. Not even close. In fact, somehow, over those 94 years, with the same amount of bull and bear markets, **a $100 investment in the S&P 500 would have grown to $863,000 in 2020**[1].

The 17 bear markets produced declines between 21% and 80%, while the range of the bull rises was between 21% and 936%. In all fairness, bull markets have an advantage: a bear market is limited to 100% on the downside.

Nevertheless, even with a narrower possible range for bear markets, rising markets have made up for losses many times over.

The chart shows not just how dramatic the bounces are following bear markets, but another important aspect of bulls: They tend to last much longer. The average bull market lasted 56 months (nearly 5 years), while bears averaged just 10 months.

EXHIBIT 1
BULL AND BEAR MARKETS 1926–2020



Source: Dimensional Fund Advisors

The bear markets seem to be bound by more than the 100% rule. Other than the Great Depression, no market drop has exceeded 51%, and only four of the 17 were more than 40%. The average percentage drop (not accounting for different values) was about 33.9%. On the bull side, ten of the 17 boom periods amounted to 100% or more, with **an average of 256%!**

Of course, not every bear will be 33% and not every bull will be 256%. Investing would be a lot simpler if they were! But it's easy to see how a few relatively small pullbacks followed by giant advances can lead to tremendous growth in a portfolio over time.

So how does the bear of March 2020 fit in? From peak to trough, February 19 to March 23, the S&P fell 33.9%, the same as the 94-year average. (No, I didn't plan that!) As of the day I am writing this, the S&P has already come all the way back and is trading higher than it was on February 19. Does it go up another 200% from here? No idea. But it is clear that discipline has rewarded long-term investors, and there's no reason to doubt it will continue to, whether now or in the future.

—Steve Tepper

[1] www.officialdata.org

Past performance is no guarantee of future results. Indices are not available for direct investment; therefore, their performance does not reflect the expenses associated with the management of an actual portfolio.

In USD. Chart end date is 3/31/2020, the last peak to trough return of −23% represents the return through March 2020. Due to availability of data, monthly returns are used January 1926 through December 1989; daily returns are used January 1990 through present. Periods in which cumulative return from peak is −20% or lower and a recovery of 20% from trough has not yet occurred are considered Bear markets. Bull markets are subsequent rises following the bear market trough through the next recovery of at least 20%. The chart shows bear markets and bull markets, the number of months they lasted and the associated cumulative performance for each market period. Results for different time periods could differ from the results shown. A logarithmic scale is a nonlinear scale in which the numbers shown are a set distance along the axis and the increments are a power, or logarithm, of a base number. This allows data over a wide range of values to be displayed in a condensed way.

Dimensional Fund Advisors LP is an investment advisor registered with the Securities and Exchange Commission.

LUMP-SUM INVESTING VS. DOLLAR-COST AVERAGING

Some investors favor a ***dollar-cost averaging (DCA)*** approach to deploying their investment capital. Unlike ***lump-sum investing***, in which the full amount of available capital is invested up front, DCA spreads out investment contributions using installments over time. The appeal of DCA is the perception that it helps investors "diversify" the cost of entry into the market, buying shares at prices that fall somewhere between the highs and lows of a fluctuating market. So what are the implications of DCA for investors aiming to generate long-term wealth?

Entry Level

Let's take the hypothetical example of an investor with $12,000 in cash earmarked for investment in stocks. Instead of buying $12,000 in stocks today, an investor going the DCA route buys $1,000 worth of stocks each month for the next 12 months. If the market increases in value each month during this period, the DCA investor will pay a higher price on average than if investing all up front. If the market decreases steadily over the next 12 months, the opposite will be true.

While investors may focus on the prices paid for these installments, it's important to remember that, unlike with the lump-sum approach, a meaningful portion of the investor's capital is remaining in cash rather than gaining exposure to the stock market. During the process of capital deployment in this hypothetical example, half of the investable assets on average are forfeiting the higher expected returns of the stock market. For investors with the goal of accumulating wealth, this is potentially a big opportunity cost.

Despite the drawbacks of dollar-cost averaging, some may be hesitant to plunk down all their investable money at once. If markets have recently hit all-time highs, investors may wonder whether they have already missed the best returns and so ought to wait for a pullback before getting into the market. Conversely, if stocks have just fallen and news reports suggest more declines could be on the way, some investors might take that as a signal waiting to buy is the wiser course. Driving the similar reactions to these very different scenarios is one fear: what if I make an investment today and the price goes down tomorrow?

Exhibit 2 puts those fears in a broader context. It shows the average annualized compound returns of the S&P 500 from 1926–2019. After the index has hit all-time highs, the subsequent one-, three-, and five-year returns are positive, on average. After the S&P 500 has fallen more than 10%, the subsequent one-, three-, and five-year returns are also positive, on average. Both data sets show returns that outperform those of one-month Treasury bills. Overall, the data do not support that recent market performance should influence the timing of investing in stocks.

EXHIBIT 2—HIGHS AND LOWS

AVERAGE ANNUALIZED COMPOUND RETURNS AFTER MARKET HIGHS AND DECLINES, 1926–2019

		Forward Period		
		1 Year	3 Years	5 Years
After New Market Highs	S&P 500	13.9%	10.5%	9.9%
	One-Month U.S. Treasury Bill	3.9%	4.1%	4.1%
After Market Decline of More than 10%	S&P 500	11.3%	10.2%	9.6%
	One-Month U.S. Treasury Bill	1.9%	2.0%	2.0%

Past performance is not a guarantee of future results.

Different Strokes

Both theory and data suggest that lump-sum investing is the more efficient approach to building wealth over time. But dollar-cost averaging may be a reasonable strategy for investors who might otherwise decide to stay out of the market altogether due to fears of a large downturn after investing a lump sum.

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The stock market has offered a high average return historically, and it can be an important ally in helping investors reach their goals. Getting capital into stocks, whether gradually or all at once, puts the holder in position to reap the potential benefits. A trusted financial advisor can help investors decide which approach—lump-sum investing or dollar-cost averaging—is better for them. What's clear is that markets have rewarded investors over time. Whichever method one pursues, the goal is the same: developing a plan and sticking with it.

—From Dimensional Fund Advisors