# What is a **Bear Market** and **How to Invest During One?**

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Global markets are back in the throes of a ferocious bear market as jitters about inflation and tighter monetary policy grip investors.

Coupled with the ongoing Russia-Ukraine war and a slowdown in China's economy, volatile swings in markets have become increasingly commonplace that can unnerve investors especially those that are experiencing it for the first time.

But that doesn't mean you should stop investing.

Here is your survival kit on (almost) everything you need to know about a bear market and how to invest and prosper in one.

## What is a bear market? And why is it called a bear?

A bear market is a term used to describe a sustained drop in investment prices by 20% or more over a period of time. It can be applied to broad market indices or even individual stocks. This month for example, the S&P 500 index officially entered a bear market after falling more than 21% YTD.

It is often characterised by pessimism over the market's direction where good news is ignored and investors hone in on disappointment. Investors would then start panic selling which push prices further down and subsequently creates a vicious cycle that repeats itself. While bear markets can stage occasional relief rallies, the general direction is still downward until it reaches a trough.

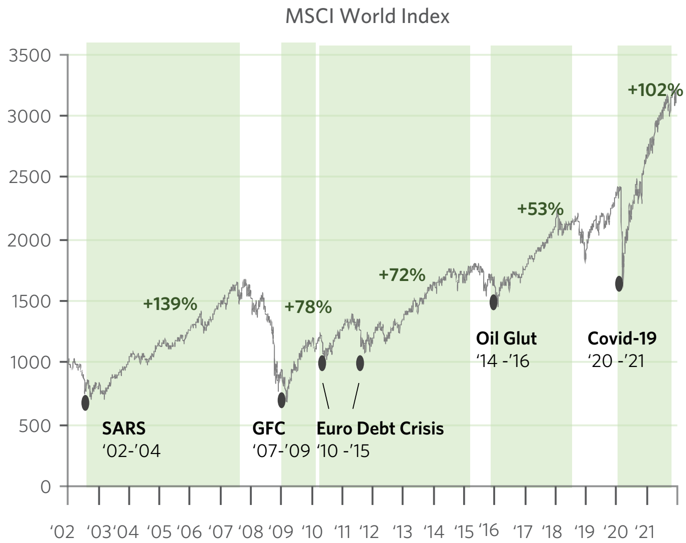
There are different theories of how a bear market got its name. A bear would attack its prey by swiping its claw downwards which is similar to a declining market trend. The other Wall Street folklore is that because bears hibernate, they are often equated to a retreating market. In contrast, the term for a surging market is called a bull market because bulls charge upwards with its horns.

## What causes a bear market and how long do they last?

Bear markets often coincide with an economic recession, though not all the time. It can also occur in ebullient market conditions or when the economy overheats causing a pullback in risk assets. In fact, some argue that bear markets are even a "necessary" part of any long-term market cycle to take off the froth in asset prices and flush out speculation. For instance, the dotcom crash in 2000 was triggered when the tech bubble burst due to skyrocketing valuations that reached unsustainable highs.

Bear markets come in all forms of size and length. According to Investopedia, between April 1947 and April 2022 there have been 14 bear markets, ranging from as short as 1 month to 1.7 years. The size of the drop varied in severity from a 20.6% decline and as much as 51.9%, if we take the S&P 500 as a gauge.

The last bear market we experienced was of course in 2020 at the onset of the COVID pandemic, where the MSCI World Index plunged by over 33%. But the recovery was equally swift and rapid, where global equities recouped back all its gains in over a month and have climbed to new highs since. While bear markets can feel like forever, the truth is that it doesn't last for long. Historically, we've seen markets recovering from every downturn to eventually climb to new highs.




| Event | Market Decline | Subsequent Market Rebound |
|---|---|---|
| SARS | -31% | 139% |
| Global Financial Crisis | -59% | 78% |
| European Debt Crisis | -16% | 72% |
| Oil Glut | -18% | 53% |
| Covid-19 | -33% | 102% |

*Source: Bloomberg Period: 1 January 2002 until 31 December 2021.*

## So what's waking up the bears in markets this time?

Very simply, it's the "I-word" that is inflation. A red-hot inflation print has led the US Federal Reserve (Fed) to embark on its biggest monetary tightening move since 1994 to tame inflation. In June, the Fed raised interest rates by 75 bps in response to a strong CPI (Consumer Price Index) reading in May that rose by 8.6% y-o-y.

For the past decade, markets have been fed a steady dose of low interest rates and ample liquidity which kept markets buoyant. Now with central banks tightening the taps, investors are going through a withdrawal episode.

Tighter monetary policy is aimed at cooling down the economy by making it more expensive to borrow. However, the fear now is that it could also trigger a recession if the Fed raises rates too high or too quickly.

The Russia-Ukraine conflict which has stretched for over 3 months is also rattling global supply chains and have pushed up the prices of commodities as both countries are major wheat producers. Disruptions caused by targeted COVID lockdowns in major cities in China are also adding to headwinds and stalling growth.

## What should investors do in a bear market then?

It all depends on your time horizon and holding power. While selling your positions in a bear market can help staunch the bleeding in your portfolio, it would also mean crystallising your losses which prevents you from making any future gains when markets rebound.

To illustrate, here's how an investment worth RM100,000 changes over the course of some of the scariest market events, when an investors chooses either one of these 3 options:-

- Withdrawing the entire portfolio to cut losses;
- Hold and ride out the market; and
- Topping up an extra RM100,000 during each downturn.

Action 1: Cut loss in every market downturn

| Event | Principal (RM) | Market Decline | % Required to Breakeven | Subsequent Market Rebound | Profit/Loss (RM) | Investment Value (RM) |
|---|---|---|---|---|---|---|
| SARS | 100,000 | -31% | 45% | 139% | -31,163 | 68,837 |
| Global Financial Crisis | 100,000 | -59% | 141% | 78% | -58,540 | 41,460 |
| European Debt Crisis | 100,000 | -16% | 19% | 72% | -15,860 | 84,140 |
| Oil Glut | 100,000 | -18% | 21% | 53% | -17,588 | 82,412 |
| Covid-19 | 100,000 | -33% | 50% | 102% | -33,323 | 66,677 |

An investor who chooses Action 1 where he cuts losses at every downturn would see his initial investment principal of RM100,00 at the start of 2002 dwindle to just RM 66,667 by the end of 2021. With no chance of riding the subsequent market recovery, the investor would miss out on a huge chunk of returns that can help him breakeven.

Action 2: Hold and ride out every downturn

| Event | Principal (RM) | Market Decline | % Required to Breakeven | Subsequent Market Rebound | Profit/Loss (RM) | Investment Value (RM) |
|---|---|---|---|---|---|---|
| SARS | 100,000 | -31% | 45% | 139% | +64,570 | 164,570 |
| Global Financial Crisis | - | -59% | 141% | 78% | +21,231 | 121,231 |
| European Debt Crisis | - | -16% | 19% | 72% | +75,877 | 175,584 |
| Oil Glut | - | -18% | 21% | 53% | +121,913 | 230,078 |
| Covid-19 | - | -33% | 50% | 102% | +199,167 | 342,869 |

In contrast, an investor who chooses Action 2 to ride out the downturn is able to reap the subsequent market rebound by virtue of just keeping still and doing nothing. As seen above, the investor has tripled his investment amount to RM342,869 from RM100,000. While it can seem scary to see your portfolio being wiped out at the onset of a "new" market crisis every other year like a pandemic or recession, it pays to stay the course. This is where diversification also comes in a risk-reduction strategy by lowering portfolio volatility and smoothening returns.

Action 3: Top-up another RM100,000 in every market downturn

| Event | Principal (RM) | Market Decline | % Required to Breakeven | Subsequent Market Rebound | Profit/Loss (RM) | Investment Value (RM) |
|---|---|---|---|---|---|---|
| SARS | 200,000 | -31% | 45% | 139% | +203,642 | 403,642 |
| Global Financial Crisis | 300,000 | -59% | 141% | 78% | +175,023 | 475,023 |
| European Debt Crisis | 400,000 | -16% | 19% | 72% | +460,417 | 861,567 |
| Oil Glut | 500,000 | -18% | 21% | 53% | +740,185 | 1,240,185 |
| Covid-19 | 600,000 | -33% | 50% | 102% | +1,274,115 | 1,874,115 |

*Source: Bloomberg. Period: 1 January 2002 until 31 December 2021.*
*Note: Figures and examples used are for illustration purposes only.*

For the bold and opportunistic investor who tops-up RM100,000 in each of the 6 market downturns as seen in Action 3, the investor more than triples his returns to a whopping RM1.8 million from his cumulative principal of RM600,000.

Some of the best days in markets often occur during or at the end of a bear market. While we wouldn't advise you to invest in such lump sums (unless you can stomach the volatility), the better approach is to dollar-cost average (DCA) by continuously investing in fixed sums through regular intervals.

DCA would also help you lower the purchase price of your investments over time by taking advantage of market dips and reduces the risk of bad timing.

## The best way to deal with bears....

Bear markets are part and parcel of any market cycle. The good news is that it's typically short-lived and even presents a rare opportunity for long-term investors to profit from it.

Stick to your investment plan and maintain a diversified portfolio which matches your risk profile and goals so that you can wait out the downturn and ride the eventual recovery.

A well-diversified asset mix also prevents from making any sudden or excessive moves in your portfolio which can set you further back from achieving your goals.

Always take a long-term perspective and only invest money that you won't need for several years. Remember investing is a long-term game and patience is the best way to deal with a lunging bear market.

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