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Private Wealth Management

In the Markets Now

The sequel

We believe in the old saying: a picture is worth a thousand words. Here, we aim to recap recent market action and provide some perspective to investors.

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WHAT DOES YEAR TWO OFF A BEAR MARKET LOW LOOK LIKE?

Why are sequels almost always worse than the original? I'll passionately defend a handful (Empire Strikes Back? The Dark Knight??), but the reality is that it's just hard to recapture the freshness, surprise, and twists of an original. Sequels are rarely outright bad (although Jaws 3-D does exist), but they're just never quite as good.

Of course, the same is often true in markets. To continue with my shoddy metaphor, we're now approaching the final credits of a truly crazy original story: a deep bear market brought on by an unprecedented global pandemic and followed by one of the strongest market rallies of all time. **And as we approach the anniversary of the March 23 lows, the question becomes: How's the sequel to this story going to turn out?** For that, we turn to the data below from our colleagues at Strategas.

So what's the story? It turns out that robust rallies are common in the first year off a bear market low (~40% on average). Pretty good! And this time was no exception; 75% in eleven months is historically strong. But what about year two, the sequel? Well, the good news is the party doesn't usually stop right away. Instead, the second year of a new bull market tends to deliver solid, if more muted returns (~13% on average). Not bad at all.

One note of caution comes from the final column, which shows that bigger drawdowns can be common in year two. Both 1982 and 2009—two of the best comparisons for our current rally—saw 14%+ selloffs and choppy trading environments. While these corrections ultimately proved transient (blips in much larger and longer bull runs), being prepared for heightened volatility is an important takeaway from this data.

S&P 500 Performance off Bear Market Lows

Bear Market Low	1st year off low	2nd year off low	Max year-2 drawdown
Nov. 22, 1957	31.0%	9.7%	-9.2%
June 26, 1962	32.7%	17.4%	-6.5%
Oct. 7, 1966	32.9%	6.6%	-10.0%
May 26, 1970	43.7%	11.1%	-11.0%
Oct. 3, 1974	38.0%	21.2%	-5.1%
Aug. 12, 1982	58.3%	2.0%	-14.7%
Dec. 4, 1987	21.4%	29.3%	-9.2%
Oct. 11, 1990	29.1%	5.6%	-6.8%
Oct. 9, 2002	33.7%	8.0%	-8.8%
Mar. 9, 2009	68.6%	15.7%	-17.1%
Mar. 23, 2020	75.1%	???	???
Average	**42.2%**	**12.7%**	**-9.8%**

Source: Strategas, as of 3/3/21

Finally, one big lesson that will stick with me from working and investing through this crisis (and is proven out by the first column): New bull markets start way before it feels like they should. When the rally began on March 24 the pandemic was in its infancy, not a single vaccine was even in a Phase II trial, and my city was an absolute ghost town. In no way, shape, or form did it feel like stocks should be rallying. Months later, the S&P 500 made a new all-time high amid a still-roiling pandemic and on the heels of one of the worst GDP prints in history. **Stocks are forward-looking machines—they'll almost always rally before it feels good.** And by the time it does, many of the gains will have already been made. Remember, the S&P 500 was up ~60% (!) by the time Pfizer's vaccine announcement (hopefully) marked the beginning of the end of the pandemic.

In the end, nothing is guaranteed in markets. The table above provides an excellent outline for what the next year could look like—positive returns, heightened volatility—but it's just a best-guess. In the end, your financial plan (and your ability to stick to it) is the only thing that truly matters. Call your Baird Advisor today to discuss this or anything else on your mind.

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