

Part 5 Understanding and Profiting from Recessions and Bear Markets Worst Bear: Recessions, Worst and Mildest Bear Markets

In this Special Report, we analyze the worst and also the mildest bear markets. We also take a historical look at recessions and will answer the questions: what causes them, how long do they last, what defines a recession, how often do they occur. We also briefly compare past recessions and bear markets to today's markets and economy.

WORST BEAR MARKETS

Below is a table of the worst bear markets:

	YEAR	LOSS		MONTHS FROM PEAK TO TROUGH	YEARS TO RETURN LAST PEAK	HIGH P/E	NORMAL ECON CYLCE
WORST BEAR MARKETS							
1	1929 TO 1932	89.00%		34.63333	25.20	YES	YES
2	1919 TO 1921	47.60%		21.66667	5.53	NA	YES
3	1973	45.10%		23	9.80	YES	YES
4	1937 TO 42	41.30%		31.96667	5.59	YES	
5	2000	38.80%		33.3	6.84	YES	YES
6	1987	36.10%		2	3.33	YES	YES
	AVERAGE	49.65%		20.9381	8.04		

These markets took longer to find a bottom, almost two years, and took even longer, 8 years to reach the previous peak.

An important determinant of how bad a bear market will be is valuations. A good valuation metric is P/Es. If P/Es are high and the economy slows those P/Es can contract meaning a dramatic fall in prices.

Below are the causes of the worst bear markets. The causes are varied. The common thread of 4 out of the 5 worst bear markets are substantially declining earnings.

	YEAR	CAUSE1	CAUSE 2	CAUSE 3	EARNING PREVIOUS	EARNING OF BEAR MKT	EARNING DECLINE
WORST BEAR MARKETS		WORST BEAR MARKETS					
1	1929 TO 1932	LEVERAGE	BAD ECON PLCY	DFLTN	19.14	-0.51	-102.66%
2	1919 TO 1921	DFLTN			NA	NA	NA
3	1973	Oil Embargo	Inflation	STAGFLATI	99.56	75.6	-24.07%
4	1937 TO 42	WWII			11.49	6.01	-47.69%
5	2000	Tech Wreck	911	Corporate Scandals	485	369.51	-23.81%
6	1987	Derivatives	Falling \$	Oil px up	115.59	133.05	15.11%

MILD BEAR MARKETS

Below is a table of the mildest bear markets. Notice that these bear markets did not take long to find a bottom and did not take long to return to its peak.

High valuations, P/Es were not a problem, most of the time. The current bear market has low valuations and could keep the market from entering the worst category of bear markets.

DOW 30 MILD BEAR MARKET LOSSES								
YEAR	HIGH	LOW	LOSS	PEAK	TROUGH	MONTHS FROM PEAK TO TROUGH	YEARS TO RETURN LAST PEAK	HIGH P/E
1994	3,945.43	3521	10.76%	1/31/1994	4/4/1994	2.1	1.06	NO
1984	1,287.20	1087	15.59%	10/10/1983	7/24/1984	9.6	1.29	NO
1923	105.38	85.76	18.60%	3/23/1923	10/27/1923	7.266667	2.69	NA
1998	9,337.97	7539	19.26%	7/17/1998	8/31/1998	1.5	0.48	YES
1990	2,999.75	2365	21.20%	7/16/1990	10/11/1990	3	0.76	NO
1917	110.15	65.95	21.20%	11/21/1916	12/19/1917	13.1	2.87	NA
1946 - 49	212.50	163.2	23.20%	5/29/1946	5/17/1947	12	3.90	YES
1981	1,024.05	776.9	24.10%	4/27/1981	8/21/1982	16	1.50	NO
AVERAGE			19.24%	AVG.		3.398246	0.81	

Below are the causes of the mild bear markets.

Notice earnings did not decline much. In the current bear markets, earnings are declining dramatically, but if you take out banks and housing the earnings picture looks better – so far.

	YEAR	CAUSE1	CAUSE 2	CAUSE 3	EARNING PREVIOUS	EARNING OF BEAR MKT	EARNING DECLINE
WORST BEAR MARKETS		WORST BEAR MARKETS					
1	1929 TO 1932	LEVERAGE	BAD ECON PLCY	DFLTN	19.14	-0.51	-102.66%
2	1919 TO 1921	DFLTN			NA	NA	NA
3	1973	Oil Embargo	Inflation	STAGFLATI	99.56	75.6	-24.07%
4	1937 TO 42	WWII			11.49	6.01	-47.69%
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RECESSIONS

Most recessions are caused by rising inflation that leads to the fed raising rates.

Old definition – 2 quarters of declining GDP

Definition according to NBER - A recession is a significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production, and wholesale-retail sales. A recession begins just after the economy reaches a peak of activity and ends as the economy reaches its trough. Between trough and peak, the economy is in an expansion.

<http://www.nber.org/cycles/recessions.html>

Most business recessions last around 10.9 months.

Below is a table that lists all the recessions going back to 1921 with its causes.

Price instability (deflation or inflation) tend to make recessions and bear markets worse, especially deflation.

Over the last 30 years, derivatives and oil have been important variables to recessions and bear markets.

YEAR OF BEAR MKT	RECESSION	CAUSE 1	CAUSE 2	CAUSE 3	FED RAISES RATES	DERIVATIVES	OIL
2001	YES	Tech Wreck	911	Corporate Scandals	Y	N	Y
1998	NO	Asian Conatgian	Russian Defaut	LTCM	N	Y	N
1994	NO	Mexican Peso Collapse	Orange County Bnrkrptcy		N	Y	N
1991	YES	Gulf War I	Banking Liquidity	High oil prices		N	Y
1987	NO				N	Y	Y
1984	NO	Strong GDP	Volker raises rates		N	N	N
1981	YES			STAGFLATION	Y	N	Y
1976	NO	Inflation		STAGFLATION	Y	N	
1973	YES	Oil Embargo	Inflation	STAGFLATION	Y	N	Y
1968	NO				Y	N	
1966	NO				Y	N	
1961	YES	Kenndy - steel prices	Cuban Missle Crisis		Y	N	
1953 TO 1954	YES	Economist predict depression			NO BEAR MARKET		
1949	YES	Overheating Economy	Inflation	Strikes		N	
1929 TO 1932		LEVERAGE	BAD ECON PLCY	DFLTN		N	
1919 TO 1921				DFLTN		N	
1914	WWI						
1917	U.S. ENTERS WWI						

TODAY, 2008

BULLISH CASE

Low Valuations, P/Es

Strong Balance Sheets

Fiscal and Monetary Policies

Decoupling, global growth could mitigate U.S. slowdown

BEARISH CASE

High probability of recession

Credit Crisis

Overleveraged consumer, banks, investment banks, investors, traders

Bursting of housing bubble

Historically high food and oil prices

Potential for inflation

Questions

Earnings? If banking and housing and some consumer companies are left out, earnings are ok – so far.

Types of Major Market Reversal Patterns for Past Tops, Bear Markets

DOW 30 BEAR MARKET LOSSES TA					
YEAR	HIGH	LOW	LOSS	TOP	MONTHS (APPROX)
2000	11,908.23	7288.27	38.80%	Rounding	30
1998	9,337.97	7539.07	19.26%	Rounding	5.5
1994	3,945.43	3520.8	10.76%	NO	
1990	2,999.75	2365.1	21.20%	NO	
1987	2,722.42	1738.74	36.10%	NO	
1984	1,287.20	1086.57	15.59%	Rounding	10
1981	1,024.05	776.92	24.10%	Rounding	13
1976	1,014.79	74.12	26.90%	Rounding	9
1973	1,051.70	577.8	45.10%	Rounding	13
1968	995.21	631.16	35.90%	Rounding	12
1966	995.15	744.32	25.20%	H & S	10
1961	734.91	535.76	27.10%	H & S	12
1946 - 49	212.50	163.21	23.20%	Rounding	9
1939 TO 41	155.92	92.92	41.30%	Rounding	24
1929 TO 1932	381.17	41.22	89.00%	Rounding	10
1923	105.38	85.76	18.60%	Double Top	12
1919 TO 1920	119.62	63.9	47.60%	Rounding	6
1917	110.15	65.95	40.10%	H & S	18
AVG. TOPPING PHASE LENGTH					13.821429

Most market tops were "Rounding Tops, Umbrellas". You will find different patterns among individual stocks when they are topping out.