Advisors Capital Management

HOW WILL THE BULL MARKET END— **AND WHAT CAN YOU DO TO PREPARE?**

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As a nation, we've seen 14 bull markets since the Great Depression. Today, stocks are at an all-time high as the market continues to rally. We know that it will end. What we don't know is when or how.

Historically, bull markets don't die of old age; they end abruptly at the proverbial hands of an executioner. Before we look into our crystal ball for the possible scenarios that await us, let's go back in time with a brief history lesson on how each bull market to date met its demise

Recovery from the Great Depression (1932 - 1937)

Running for 57 months, the bull market of 1932 saw an increase of 325%. The strong recovery from 1933 -1937 concerned the Fed, which feared a rise in inflation at a time of enormous excess bank reserves that could fund loans and further growth. So, the Fed doubled reserve requirements, which precipitated a sharp recession and a 66% decline in stock prices. Spurred on by fears that the economy might be developing speculative excess, the Federal Reserve came in and raised interest rates too aggressively, and stocks declined by 66%.

World War II Rally (1942 - 1946)

The WWII market rallied 158% as war efforts led to a radical increase in demand and massive jobs creation. When the war ended, too much supply was floating around, leading to an inventory recession and a 30% decline in the S&P 500.

Post War Recovery (1949 - 1956)

After WWII, troops came home, married, started families and bought new homes. Consumerism flourished, as factories shifted from military to consumer goods. Automobiles and TVs were a mainstay in most American homes, and the market rose 266%. The Federal Reserve "took away the punch bowl" when they raised rates. The market responded with a 22% drop.

Cold War Takes Hold (1957 - 1961)

The 50-month bull market of the Cold War saw an 86% upward move in the S&P 500. Unlike the others, this bull market had no executioner. Stocks were simply overvalued, and the market corrected itself. As a result, the S&P 500 dropped 28%.

JFK Motivates America (1962 - 1966)

Boasting an 80% S&P 500 increase, JFK's tax cuts started a new bull market that reduced unemployment rates and unleashed a strong economy. Lyndon Johnson's Great Society Program spending, plus U.S. spending on the Vietnam War reinforced growth and reduced unemployment to historically low levels. As inflation started to pick up, the Fed raised interest rates and tightened credit conditions. The massively restrictive credit crunch resulted in a 22% drop in the S&P 500 between February and October 1966.

The mid-60s (1966 - 1968)

Though the bull market of the mid-1960s was the shortest in history, the S&P 500 managed to move to 48% during that time. As with the previous bull market, unemployment was low, and the economy was thriving. Policy oscillated between trying to rein in inflation and trying to avoid getting in the way of social and military spending. But political and social instability, coupled with rising inflation, gave way to a 36% drop.

The Nifty Fifty (1970 - 1973)

During the bull market of the early seventies, the country's largest and fastest-growing companies (the Nifty Fifty) dominated as they became household names. The market topped off at 74%, even as inflation rose to unprecedented levels. Nixon stepped in to take the dollar off the Gold Standard and imposed assorted wage, price, and rent controls. Companies raised prices, and landlords raised rents which led to runaway inflation. The market sold off by 48%.

A Modest Bull Market (1974 - 1980)

Beginning October 1974, the six-year bull market of the mid-to-late-seventies saw a 126% boost. G. William Miller, the Fed Chair, refused to raise interest rates to combat inflation. After he was replaced with Paul Volcker, the Fed raised interest rates as high as 20% to tame the double-digit inflation, which crushed all the interest rate sensitive sectors of the economy and a sharp recession ensued.

Reaganomics (1982 - 1987)

After Reagan cut taxes in 1982, the economy enjoyed a strong expansion and the S&P 500 responded with a 229% jump. Again, inflation picked up and the Fed started to raise interest rates. Then came Black Monday on October 19, 1987, when the market saw the biggest single-day decline in history. A new investment product, portfolio insurance that offered to protect investors, actually exacerbated the decline by increasing the selling as stock prices fell. As the first black swan event in stock market history, the crash ultimately led to systemic changes that would prevent the market from ever seeing a drop like that again.

The Black Monday Comeback (1987 - 1990)

The Fed, under Alan Greenspan, aggressively increased liquidity following the collapse, which turned the market around. The second shortest bull market in modern history, the Black Monday Comeback saw a 65% bump in the S&P 500. But when Iraq invaded Kuwait, oil prices more than doubled, leading to a new recession and a 19.9% drop in stock prices. This time, the market was murdered by oil prices, not the Fed.

The Age of the Internet (1990 - 2000)

The 90s saw the longest period of economic growth in modern history with the rise of the internet. The S&P 500 jumped 417% over 113 months during a time of what Alan Greenspan referred to as "irrational exuberance." Y2K forced many companies to spend aggressively to prepare for systems to work after the turn of the calendar and the economy weakened when that spending stopped. The frothy share valuations could not justify the fundamentals, and most of the "thriving" dot coms went under.

The Housing Boom (2002 - 2007)

The 60-month bull market of the mid-aughts saw a 102% increase on the strength of excessive speculation in housing. 2008 ushered in a housing crisis with too many houses built, a sub-prime mess that provided funds for non-creditworthy borrowers to speculate, and cascading defaults among major financial institutions as borrowers defaulted. Enter: The Great Recession.

The Recession Recovery (2009 - 2020)

All was well in the 10-year period that marked the longest bull market in history with slow and steady growth and the rise of tech giants like Amazon, Apple, and Facebook. March 2020 roared in with another black swan event when COVID-19 ravaged the world. Governments shut down many business operations to contain spread of the pandemic, which triggered a sharp, deep recession. Stock prices fell precipitously.

COVID Recovery (2020 - present)

Massive Covid stimulus and record low interest created the present-day bull market.
What comes next?

WHAT COULD KILL **TODAY'S BULL MARKET?**

Despite the aforementioned crystal ball, we do not have omniscient powers to peer into the future. What we do have is a deep level of insight into the most likely "executioner" of what is now referred to as the Covid Recovery bull market. Below are five potential scenarios with recommendations on how to build portfolios in response to each:

1. The Fed raises rates too aggressively or too soon

Thus far in this bull market, the Federal Reserve has been slow to normalize policy. It has maintained that rising inflation is mostly transitory and it should allow the expansion to bring down unemployment further. But that is likely to change in the coming months—possibly as soon as November. Inflation is rising, unemployment is low, and wage inflation is on the rise. They've got all the reasons to act. Should the Fed change it views, or the markets gag on higher inflation, rates could rise more and faster than is commonly assumed. Under this scenario, you'll want to focus on banks, lenders, insurance companies, short-term bonds, and consumer discretionary energy companies while avoiding growth stocks, utilities, and long-term bonds.

2. Another variant sweeps the world

As variants continue to emerge, we need to be on the lookout for one that aggressively rips through the vaccines and sweeps across the world the way the initial virus behaved. Here, you'll want to turn your attention to stay-at-home companies, non-discretionary companies, big techs, and long-term bonds and avoid discretionary companies (e.g., travel, hotel, restaurants) and some long-term bonds (of companies damaged directly by the next variant) and energy companies.

3. An energy crisis

As oil prices go up from the low twenties to now $85 per barrel, an energy crisis could be on the horizon. If there's a super-spike in oil to, say, $200 per barrel, this would present a significant problem. If consumers spend heavily on energy, there will be less for all forms of discretionary spending, which would likely trigger a new recession. In this case, focus on energy stocks, solar wind companies, energy oil frackers, defense stocks, and non-discretionary companies. On the flip side, you'll want to stay away from airlines, gas-powered automobile companies, and end-consumer energy companies (i.e., gas stations).

4. Valuation

As Alan Greenspan previously stated, stocks can be prone to irrational exuberance, and the ongoing rally will become vulnerable if stock prices run well ahead of underlying corporate profits. Any outside shock could trigger an economic and/or market decline, such as rising interest rates in response to higher inflation.

5. Another "black swan" makes an entrance

A black swan event could be anything—from an asteroid to a large volcanic eruption near a heavily populated area. Because there is no way to anticipate a black swan event, your best path forward is to stay with your plan. The market has always bounced back from such catastrophic events, and it will again.

Being prepared for each and knowing how to respond can be difficult to navigate for most. As a financial advisor, you should be focused on managing relationships and playing quarterback for your clients' financial plans. Knowing how to prepare for and manage the upcoming demise of our current bull market—in whatever form that takes—requires deep expertise.

That's what we do best.

At Advisor Capital Management, we are knee-deep in these scenarios every day. We know how to anticipate market changes and take a proactive approach for ensuring clients' financial security, regardless of the current condition of the economy.

Contact us today to learn more about how we can support you with portfolio management.

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Stock markets, especially non-U.S. markets, are volatile and can decline significantly in response to adverse issuer, political, regulatory, market, or economic developments. Foreign securities are subject to interest rate, currency exchange rate, economic, and political risks, all of which are magnified in emerging markets.

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