Analysis, Insights and a different perspective

INVESTMENTINSIGHTS

October 2017

Bear Market Survival Guide

Bears are among nature's most majestic creatures, but get too close to one and the experience can be terrifying. The same can be said for bear markets. Since 2000, two major declines wiped out nearly half of the stock market's value. Today, an entire generation of investors seems convinced that an appropriate investment strategy is "anything but the stock market." We disagree. On the contrary, we believe market declines are a normal part of the investment process and, if managed properly, can actually provide an opportunity for investors with a long-term perspective.

What is a Bear Market?

Stock market declines of 20% or more are referred to as "bear markets" because a bear attacks by swiping its paws downward. Stock market increases of 20% or more are referred to as "bull markets" because a bull attacks by thrusting its horns skyward.

Our advice for surviving a bear market:

- Recognize that stock market declines occur frequently and are a normal part of the investing process.
- Understand that, historically, bear markets tend to be short and have always been followed by bull markets. In the past, these bull markets have more than made up for the losses incurred.
- Know that market declines can occur at any time for any reason. They are wholly unpredictable. Attempts to avoid market declines usually result in lower long-term returns because investors rarely get back in the market in time for the next upswing.
- An investor's appropriate defense against short-term setbacks in the stock market, in our opinion, is to own quality investments in a well-diversified portfolio that is professionally managed.

	1 Yr	3 Yr	5 Yr	10 Yr
U.S. Large Stocks	19.7	10.0	13.8	7.4
U.S. Small Stocks	19.3	9.6	12.7	7.5
U.S. Bonds	0.6	2.8	2.2	4.3
Intl Markets Stocks	22.1	3.8	6.9	1.6
Intl Emerging Mkts Stocks	26.5	4.2	4.7	2.0
U.S. Inflation (CPI)	1.7	1.0	1.2	1.7

Source: Morningstar. Annualized returns for periods ended September 21, 2017. U.S. large stocks is the S&P 500 Index, U.S. small stocks is the Russell 2000 Index, U.S. Bonds is the Barclays US Aggregate Bond Index, Intl Developed Markets is the MSCI All Country World Index Ex-US, International Emerging Markets is the MSCI Emerging Markets Index. Returns include dividends and interest. Past performance is not an indication of future results. All indices are unmanaged and may not be invested into directly. The Indices mentioned in this report are unmanaged, may not be invested into directly and do not reflect expenses or fees.

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History of Bear Markets

Bear markets are often (but not always) triggered by downturns in the economy. The following table shows the history of economic contractions and expansions since 1854:

	Contractions	Expansions
Average length:		
1854-present	18 months	40 months
1945-present	11 months	63 months

Source: National Bureau of Economic Research (NBER)

As you can see, contractions tend to be short - lasting less than a year in the post-war period. On the other hand, expansions since World War II have lasted 63 months, or over five years.

The history of the stock market is similar to the history of the economy. Since 1928, the stock market, as measured by the S&P 500, has experienced 32 bull markets (defined by rallies of 20% or more) and 32 bear markets (defined by declines of 20% or more). But, historically, the bull markets have been larger in magnitude and duration than the bear markets. In fact, in the post-War period, bull markets have averaged a gain of 278% and lasted 68 months, or twice as long as the average since 1928.

The Anatomy of Stock Market Bull/Bear Market
S&P 500 (1/3/1928 to 9/19/2017)

	Average %	Average Length
Bull Markets	+158	34 months
Bear Markets	- 34	8 months

Source: Ned Davis Research

Market history suggests that market declines are quite frequent. Most dips (declines of 5%) in the Dow Jones Industrial Average don't turn into anything serious. Corrections (declines of 10% or more) occur, on average, once a year. Bear markets (declines of 20% or more) occur, on average, once every three or four years.

The Anatomy of Stock Market Bull/Bear Market
S&P 500 (1/3/1928 to 9/20/2017)

	Dips (5% or more)	Corrections (10% or more)	Bears (20% or more)
# of times	303	96	25
Per Year	3-4 per year	1 per year	Every 3-4 yrs

Source: Ned Davis Research

Why not just get out of the stock market before it goes down, then get back in before it goes back up? We believe forecasting turns in the economy and the stock market is a futile exercise.

The National Bureau of Economic Research is the official "scorekeeper" of economic recessions and expansions. Here is a list of when the last few turns in the economy were officially recognized by NBER.

Note how long it takes for the "experts" to recognize changes in the economy - 11.6 months or nearly a full year after the economy has changed direction!

Peak/Trough	Announce Date	Months
June 2009 trough	Sept, 2010	15
Dec 2007 peak	Dec, 2008	12
Nov 2001 trough	July, 2003	20
March 2001 peak	Nov, 2001	8
March 1991 trough	Dec, 1992	21
July 1990 peak	April, 1991	9
Nov 1982 trough	July, 1983	8
July 1981 peak	Jan, 1982	6
July 1980 trough	July, 1981	12
Jan 1980 peak	June, 1980	5
Average		11.6 months

Even more difficult than calling the turns in the economy is anticipating turns in the stock market. The chart at the bottom of the next page shows how, historically, the stock market turns (dips) lower *before* recessions begin, and turns (climbs) higher *before* recessions end.

Bears can't be reasoned with. Bear markets can be tamed by sticking to sound investment principles.

Surviving Bear Markets

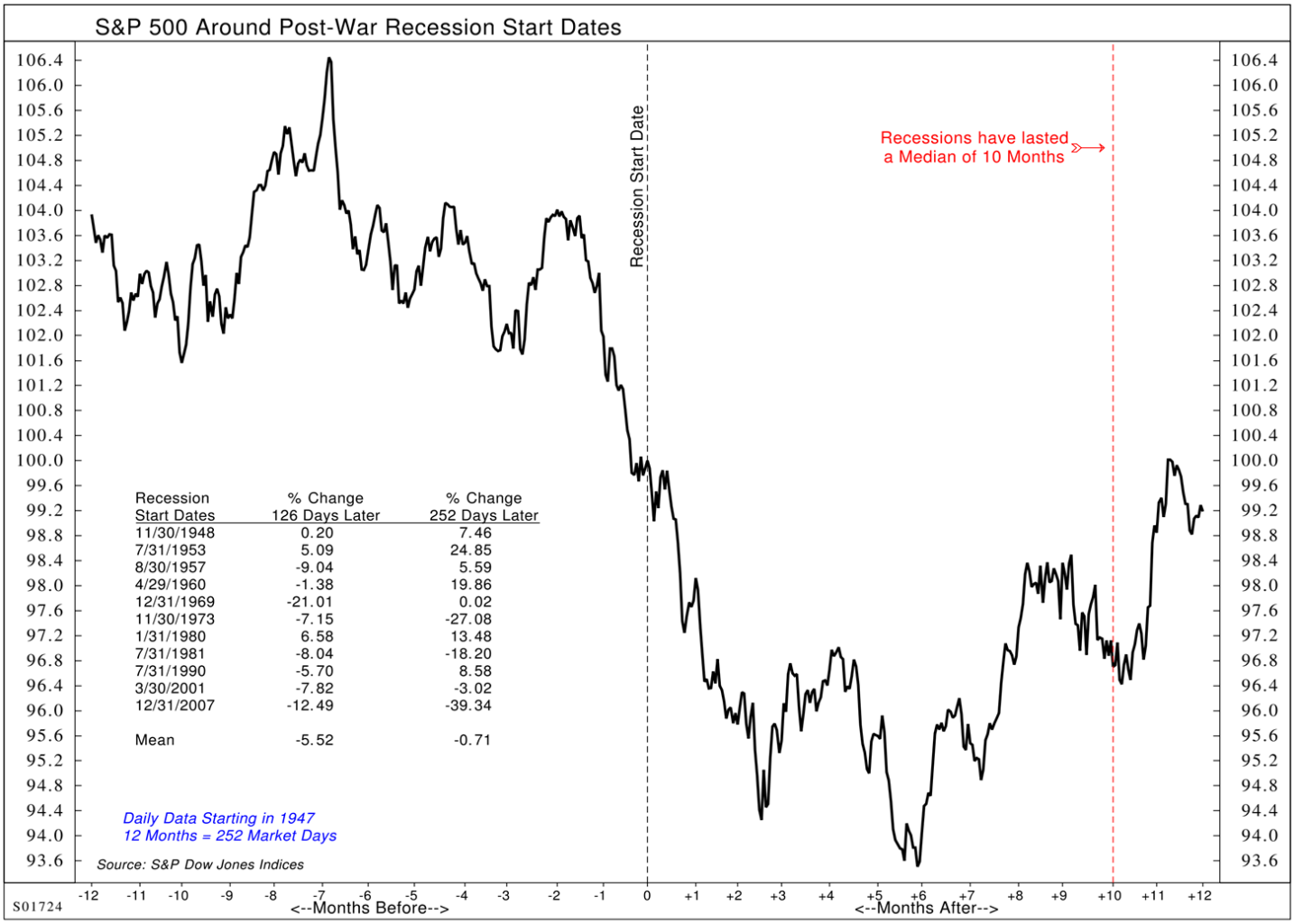
Of course, the best time to prepare for a market decline is before one happens. In our opinion, the four most important necessary elements to survive a bear market are diversification, quality, a long-term perspective, and professional management.

Understanding your tolerance for risk is an important step towards building a portfolio that can withstand a bear market. By not having all of your portfolio invested in the stock market, your portfolio should fall less than the stock market when it does go down. In other words, owning investments that are unrelated to the stock market should help dampen the impact of a stock market decline. This is the principal of diversification. Quality investments are typically those that have stood the test of time, as well as sound fundamentals. They are like tennis balls—they bounce back after they fall. Poor quality investments are like eggs—when they fall they just break. Never hold investments today that you would not want to own in a bear market tomorrow. Maintaining a long-term perspective means maintaining control of your own emotions and not making a long-term investment decision in reaction to short-term events.

It also means giving quality investments time to work. Having your investment portfolio professionally managed means having your investments professionally selected, managed, monitored, and rebalanced when appropriate, which is what takes place within our Model Wealth Program. Having a calm voice and a steady hand guiding you can be an invaluable resource when markets misbehave.

It's all about Maintaining a Long Term Perspective

Some investors look at all of this history and suggest "this time is different." They believe that the challenges we face are insurmountable, or that the prospects for the U.S. economy are significantly worse than in previous periods. They long for the "good old days" when the outlook was much rosier. We disagree. It's human nature to remember the good things that happened in the past and to forget the fact that our nation's progress was achieved only after spilling a good deal of blood, sweat and tears. Here's a little walk down memory lane of some of the challenges we faced in the past, some of which were quite a bit more difficult than what we seem to face today.



Source: Ned Davis Research

Reasons Not to Invest?

1929 Stock Market crash

1933 Great Depression, NYSE closes for Bank Holiday

1941 Pearl Harbor

1950 Korean War begins

1955 Eisenhower heart attack creates wave of selling

1961 Bay of Pigs nuclear showdown

1963 Kennedy Assassinated

1968 Tet Offensive (Vietnam), King Assassinated

1973 Arab Oil Embargo

1974 Nixon Resigns

1980 Prime rate hits 21 ½%

1982 Worst recession since WWII

1987 Market drops 508 points, or 22.6% in single day

1991 Gulf War I

2001 911 attacks

2003 U.S. invades Iraq

1997 Dow plummets 554 points on October 27

2001 Enron collapse, bursting of the tech bubble

2008 Worst financial crisis since the Great Depression

Important Disclosures:
The information contained in this report is as of September 19, 2017 and was taken from sources believed to be reliable. It is intended only for personal use. To obtain additional information, contact Cornerstone Wealth Management. This report was prepared by Cornerstone Wealth Management. The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. Content in this report is for general information only and not intended to provide specific advice or recommendations for any individual.

Investing involves risk including the potential loss of principal. No strategy can assure success or protection against loss.

Past performance is no guarantee of future results.

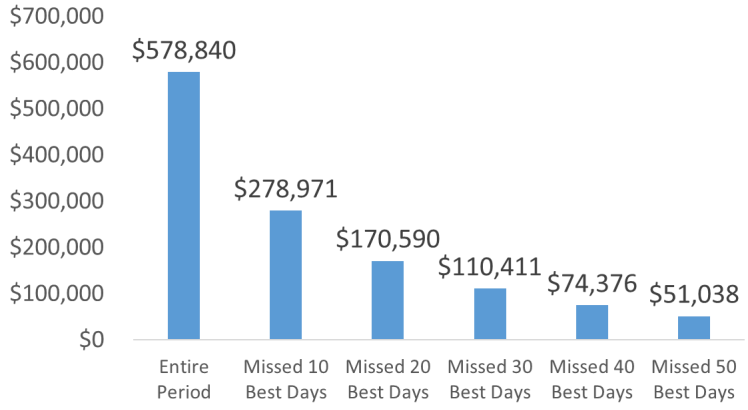
The Standard & Poor's 500 Index is a capitalization weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

Securities offered through LPL Financial, Member FINRA/SIPC.

Lessons for investors

In our view, the lessons are clear. As legendary investor Sir John Templeton once said: The four most dangerous words in investing are: this time is different. History has shown that, in spite of the many challenges we always face, our nation, and our financial markets, have always persevered. An investor's greatest ally is a calm voice and a steady hand that can guide him through difficult times. His greatest enemy is the emotions that can distract him from achieving his long-term investment goals. The emotion of fear can reach its peak during major market declines. It is our hope that this report has provided the necessary perspective to help you survive the next bear market, whenever it might occur.

Market Timing can be Problematic
Value of a $10,000 investment in the S&P 500
(Dec. 31, 1979-Mar. 24, 2017)



Source: Ned Davis Research. The S&P 500 is an unmanaged index which cannot be invested into directly. Past performance is no guarantee of future results. This is a hypothetical example and is not representative of any specific situation. Your results will vary. The hypothetical returns used do not reflect the deduction of fees and charges inherent to investing.

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