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Best Bear Market Strategy: Remain Invested in Stocks

Crazy as it sounds, history shows it's better to stay in the market rather than sell and try to time your return.

By MARK HULBERT January 27, 2016

The best bear market strategy may very well be to stay 100% invested in equities.

I know this sounds totally crazy. Can it really make more sense to stick with the market as it heads over a cliff?

Yes, according to the top long-term performers among Hulbert Financial Digest-monitored advisors. They in effect predict that your next-decade returns will be mediocre at best if you decide to go to cash right now — even if a major bear market has already started.

I defined my select group of top performers by focusing on those with the best real-world records from the market peaks preceding the last two bear markets: the major declines that began in October 2007, before the Great Recession, and in March 2000, just as the Internet bubble was bursting.

If you were devising a performance test to showcase the virtues of getting out of stocks during bear markets, you would be hard-pressed to come up with better time periods than these. The SPDR S&P 500 exchange-traded fund during the 2000-2002 bear market fell by almost 50%, and by 57% during the 2007-2009 bear market. The net effect of those two declines is that, even with intervening bull markets, the Standard & Poor's 500's annualized total return since March 2000 is just 4.1% — well less than half its historical average.

And, yet, those Hulbert Financial Digest-monitored advisors who were heavily invested in cash or other non-equity assets during either of those bear markets are not at the top of the performance scoreboards over the entire period. That's for a variety of reasons, but primarily because they failed to get back into the stock market at anywhere close to the bottoms of those bear markets. They therefore missed out on a good chunk of the

market's subsequent recovery, paying a big price for the bragging rights they had for sidestepping the bear market.

I know it's hard to accept the idea that even if you could identify market tops in real time you couldn't beat the market. In fact, many of my clients simply don't believe me when I tell them that. Below, I'll review the data that overwhelmingly make my case.

In the meantime, though, let me review the strategies employed by those advisors who are ranked highest for performance since the tops of the previous bear markets.

In first place for performance since the March 2000 market top is The Investment Reporter, edited by Marc Johnson, with a 10.9% annualized return (compared with 4.3% for buying and holding). Johnson — whose outperformance came from stock selection rather than market timing — is quite sanguine about the stock market's recent pullback, writing, "Some observers are alarmed by corrections and bear markets. They see these market setbacks as disasters. Our view is different: stock market setbacks can create wonderful buying opportunities."

A similar message comes from the editor of the service in second place since the March 2000 top: Kelley Wright, editor of Investment Quality Trends. He writes: "My thought is the market is simply taking care of the business it was on track to do last summer before the buy-the-dippers, the-Fed-will-bail-us-out-again-crowd, and Mario Draghi short-circuited the correction. Energy will eventually stabilize and find a bottom, which will allow the clouds to part and shine sun on the fact that there are some really good values in some really great companies."

In fact, each of the top-five advisors for performance since March 2000 is fully invested right now, just as each has consistently been over the last 15 years. The same goes for three of the top five for performance since the October 2007 market top.

Besides a commitment to staying invested in equities even during bear markets, these top performers also share a bias toward value stocks — those that are trading for low prices relative to various measures of their underlying value. Such stocks historically have lost less money during bear markets than high-flying growth stocks. In addition, value stocks often pay a handsome dividend, which at least somewhat eases the pain of the paper losses the bear market creates.

To illustrate the type of stocks these top performers favor, I present the accompanying list. It contains stocks that are each recommended by at least two of the five newsletters

at the top of the scoreboards for performance since the March 2000 market peak — and which, in addition, sport a dividend yield of at least 4%.

Why you're better off not trying to time the market

Let me now respond to those of you who resist the notion that it really makes better long-term sense to stay invested through a bear market.

Consider the following facts, all derived from the Hulbert Financial Digest's objective and independent monitor of several hundred stock market timing strategies. They all point to the extremely low likelihood of improving on a fully invested strategy.

- Fewer than 1 in 4 of monitored market timers had exposure levels that were any higher at the March 9, 2009, bear market bottom than at the Oct. 9, 2007, market top. This is a very low hurdle to ask a market timer to jump over, since a market timer could clear it merely by having an exposure level at the market's bottom that is just one percentage point higher than at the top. But only 24% of monitored timers were able to clear it, while 48% — one of every two, in effect — did worse than random, having lower exposure levels at the bottom than at the top. This is just what contrarian analysts would have predicted, of course: Most timers are bearish when they should be bullish, and vice versa.

- Only 6% of timers "called" both the top and the bottom of the 2007-2009 bear market. That's so low that it means, at close to the 95% confidence level sometimes used to assess whether a pattern is genuine, we can conclude that — statistically speaking — no one called both the top and bottom. And this percentage is based on very relaxed criteria for "calling" the top and bottom: I included all timers who decreased by equity exposure level by at least 25 percentage points within one month of the October 2007 high, and increased it by a like amount with a month of the March 2009 bottom.

- Only 9% of timers had markedly higher average exposure levels during the subsequent bull market than during the 2007-2009 bear market. This may be a superior way of measuring market timing abilities, since it goes straight to the heart of the matter. Believe it or not, however, only 9% of monitored market timers had exposure levels over the 17 months following the March 2009 bottom that were at least 50 percentage points higher than during the 17-month bear market prior to that bottom. Even more depressingly, 54% of the HFD-monitored

strategies actually had higher exposure levels during the bear market than in the first 17 months of the subsequent bull market — just the opposite of what you're looking for in a market timer.

- Fewer than half of those who satisfied even one of these criteria were able to do so for the 2000-2002 bear market. To distinguish between luck and skill, of course, we need to see how the small percentage of successful Great Recession market timers fared in other downturns. The numbers are not promising. Fewer than half were able to clear my hurdles in the prior bear market (the one that lasted from March 2000 through October 2007).

To bet that this time is different and that the right course of action is to go to cash or any other alternative asset class, such as bonds or gold, you have to bet that you will succeed when almost all professional market timers in the past have failed. That's a triumph of hope over experience. A far safer bet is choosing to withstand bear market losses in order to guarantee you'll capture 100% of the bull market's gains.

None of this is meant to minimize the pain of the losses during bear markets, or the emotional discipline required to stay the course. But perhaps the Hulbert Financial Digest's data will provide you some solace during bear markets: Their message is that, even if you don't beat every market timer over the long term, relative to the vast majority of them you will have the last laugh.