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BEWARE OF BEAR: CONSIDERATIONS ON THE MARKET REBOUND

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THE MARKET

March's massive global market freefall put an end to the longest market bull run in history, with the quickest sell off ever. On March 12th, European markets knelt in front of the spread of the Covid-19 plague. EuroStoxx 600 fell -11%, the index's worst day on record. DAX and CAC 40 both plunged over 12% and FTSE MIB lost 17%, reaching its lowest level since 2011. After few days, on March 16th, US market plunged to its lowest value, with the S&P500 recording -12%, one of the worst intraday falls in its history. That day US was far from the current numbers of contagion and was implementing the first Italian like lockdown measure in just few states and cities of the country, while President Donald Trump was urging US citizens against discretionary travel and gathering in groups of 10 or more people.

In order to have a broader view, it might be useful to look at the FTSE All-World index. The stock index, that covers over 3,100 companies in 47 countries, recorded a -34% from February 12th, when its value was of 383.39 points, until March 23rd, closing at 253.5.

The response from central banks was not long in coming. Fed decided to cut rates by 100 bps and to restart its quantitative easing programme, with the unprecedented decision to buy corporate debt and municipal debt, attempting to respect the "whatever it takes" Jerome Powell's promise, in order to support US economy and improve market liquidity. Few days after Mr. Trump announced the $2 trillion stimulus package. In Europe, on the same wave, the ECB decided to buy €750 billion worth of bonds, significantly expanding its asset-purchase programme to address the severe strains in financial markets. On the same day, European Commission decided to relax the Stability and Growth Pact requirements, enabling European countries to put in place their stimulus programmes.

FTSE All-World index (Jan-Apr 2020)

Since that mid-March low, almost one month ago, US stocks gained about 25% and European ones 20%, going back in bull territory. Despite the extreme uncertainty over the outlook for the global economy and for companies' earnings, roughly half of the market value lost has now been recovered.

THE INVESTMENT DILEMMA

Today all investors are wondering if it will be wise to trust governments and central banks support to the financial markets and invest now that prices are still low or if the last month epic market drop is an irrecoverable correction and the start of a new bearish phase for global financial markets.

To understand what we should expect from the market in the next few months, it might be useful to take a look at what happened in the past, after a deep pullback like the one we experimented in March. An analogy with the current situation could be seen in the 1929 crash, the 2001 dot-com bubble and the 2008 financial crisis.

Looking back to October 1929, Down Jones industrial average, during the Black Thursday, lost -11%. This is still less than the -13% loss that the index experienced on Monday 16th of March 2020, day in which, for the first time in history, NYSE halted trading for 15 minutes.

After the Black Thursday, Dow Jones had 3 days in a row of huge losses until October 30th, in which the market recorded a more solid plus 12%.

Dow Jones Industrial Average index (1929-1933)

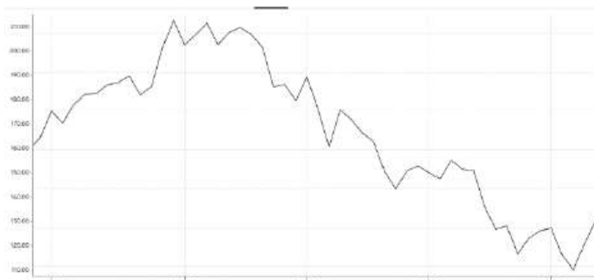
Looking at the chart, we can see how the market tried different rebounds, turning bullish between November 1929 and April 1930, but stocks continued to fall further for three years until bottoming out in July 1932. US stock market did not reach its 1929 highs until 1958.

In 2000 we saw the bursting of the dot-com bubble, a market bubble caused by excessive speculation in

Internet-related companies in the late 1990s, a period of massive growth in the use and the adoption of the Internet. The blow up of this bubble led to the global financial market downturn of the new millennium.

The index that can be used as the best thermometer for the situation is the Nasdaq Composite, since it included most of the tech companies involved in the bubble. On the 14th of April 2000, the Nasdaq Composite index fell -9%, ending a week in which, it had fallen by -25%. Afterwards, there was a consistent recovery. On the 1st of September 2000, another fall started and by the 2nd of January 2001 there was a drop of -45.9%, down -78.4% from the March 2000 level. In October 2002, the index reached its historical low level.

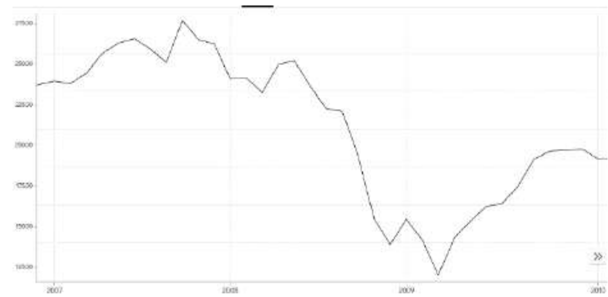
This time however, the worldwide bear run ended 3 years after, in March 2003 with different attempts of rebounds in the middle.



FTSE All-World index (1999-2003)

In the end, and most recently, the bear market of 2007–2009 was a 17-month bear market that lasted from the 9th of October 2007 to the 9th of March 2009. In this time framework, the S&P 500 index lost approximately 50% of its value, but the duration of this bear market was just below average, due to extraordinary interventions by governments and central banks to prop up the different stock markets.

Differently from today, the stock market crashed in the middle of the bear run, on the 29th of September 2008. The Dow Jones Industrial Average fell -777.68 points during the intraday trading session. Until the stock market crash of March 2020, it was the largest point drops in history. On the same day, the S&P 500 index lost -8.8%. Starting from that day, the market experienced eight consecutive trading days of negative returns.



FTSE All-World index (2007-2010)

Another interesting comparison might be the one between the volatility level in 2008, after Lehman Brothers bankruptcy, and the 2020 Covid-19 crisis. Markets tend to rally a lot after a huge negative shock and, looking at the chart below, the big move ahead we had last month is not really a surprise. An incredible similarity comes out from the two VIX paths, warning that another increase in volatility in the next weeks cannot be excluded.

Source: Bloomberg

CONCLUSION

History is not destiny. Every historic period is different, with its own and unique characteristics. Moreover, the market efficiency makes hard to assess and identify a common path through time and in similar situations. Nonetheless, even if the market is positively responding to stimulus, investors should worry about the responsiveness of the real economy, taking into account the current uncertainty and the continuing delay in the restart of the world productivity, due to the ongoing spreading of the virus and to different stages of lockdown measures.

Data shows that, once equities have tumbled -30%, the market has never taken less than six months to find its bottom and, in the bearish periods analyzed, never less than 2 and a half years. Furthermore, we must take into account that the economy is just a step away from recession and the stimulus might not be enough. According to that, global financial

markets could have further to fall and a new spike in volatility could come.

The rising prices of these days could be a merely *"bear market trap"*, a few days growth in a larger and long-term downturn. The rebounds observed in the three events analyzed were more like a dim light in the darkness that faded away quickly. Before thinking at this moment as the occasion of a lifetime to invest, investors should concretely ask themselves what comes next.

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