


One of my annual re-reads is Russell Napier's classic tome *"Anatomy of the Bear."* A mandatory study for every financial professional and investor who seeks to understand not only how damaging bear markets can be but also the traits which mark their bottoms. Every bear is shaken from hibernation for different reasons. However, when studying the four great bottoms of bears in 1921, 1932, 1949 and 1982, there are several common traits to these horrendous cycles. I thought it would be interesting to share them with you. First, keep in mind, bear markets characteristically purge weakness - weak companies, weak advisors, weak investors. I want you to consider them less a bloodletting and more a cleansing of a system. There will be unsuitable investors who will never return to the market and justifiably so. Businesses that were patronized pre-Covid, will either be gone or completely reinvent. Bear markets slash equity valuations. Unfortunately, this doesn't mean that stocks return to healthy valuations quickly after a bear departure. Some believe the global economy can turn on and off like a light switch without major repercussions. In other words, the belief is once the worst of this horrid virus ceases, business activity invariably will return to normal. I believe it'll be quite the contrary.

I mentioned on the radio show in December that I expected wage growth to top out in 2019. Keep in mind, through this yet another outlier economic upheaval, there will be employers who will realize they don't require as many employees and will let them go or cap their wages for years to rebuild profit margins. Without the tailwind of stock buybacks to equity prices, corporate employees will bear the brunt of the pain. In addition, organizations will realize many of their remaining employees are equipped to work from home and perhaps gather in-person perhaps once a month or every couple of weeks. Thus, large commercial space will no longer be required which is going to require massive reinvention by the commercial real estate industry.

The cry of nationalism will rise. Products manufactured overseas especially China, will take a hit which means Americans will face greater inflationary challenges while also dealing with muted or non-existent wage growth. We will experience 'more money chasing too-few goods.' Many, especially younger generations will continue to strip themselves down to basics (I especially envision this in Generation Z; those born in the mid-late 1990s such as my daughter Haley). This sea-change will require most of the U.S. population to finally live below their means, dramatically downsize, reinvent, expand, the definition of wealth to include more holistic, ethereal methods that go way beyond household balance sheets and dollars.

I hope I'm wrong. So very wrong about most of what I envision for the future.

Here are several traits that every major market bottom share - courtesy of Russell Napier:

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### 1. **Bears tend to die on low volume, at least the big bears do.**

Low volume represents a complete disinterest in stocks. Keep in mind this clearly contradicts the tenet which states that bears end with one act of massive capitulation - a downward cascade on great volume. Those actions tend to mark the *beginning* of a bear cycle, not the end. A rise in volume on rebounds, falling volumes on weakness would better mark a bottoming process in a bear market. 2. **Bears are tricky.** There will appear to be a recovery; an 'all-clear' for stock prices. It'll suck in investors who believe the market recovery is upon us just to be financially ravaged again. Anecdotally, I know this cycle isn't over as I still receive calls from people who are anxious to

get into the market and perceive the current market a buying opportunity. At the bottom of a bear, I should be hearing great despair and clear disdain for stock investing. 3. **Bears can be tenacious.** They refuse to die or at the least, quickly return to hibernation. The 1921 move from overvaluation to undervaluation took over ten years. Bear markets, where three-year price declines make overvalued equities cheap, are the *exception, not the rule*. As of this writing, the Shiller P/E is at 24x - hardly a bargain. At the bottom market cycle of the Great Recession, the Shiller CAPE was at 15x. There is still valuation adjustment ahead. 4. **Bears can depart before earnings actually recover.** Investors who wait for a complete recovery in corporate earnings will arrive late to the stock-investment party. Most likely it's going to take a while (especially with their debt burden), for the majority of U.S. companies to reflect healthy earnings growth. CEOs who employ stock buybacks to boost EPS will be considered pariahs and gain unwanted attention from Congress and even the Executive Branch. My thought is a savvy investor should look to minimize indexing and select individual stocks with strong balance sheets which include low debt and plenty of free cash flow within sectors and industries that are nimble to adjust to the global economy post-crisis.

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5. **Bear market damage can be inconceivable, especially to a generation of investors who never experienced one.** The bear market of 1929-32 was characterized by an 89% decline. The average is 38% for bears; however, averages are misleading. I have no idea how much damage this bear ultimately unleashes. The closest comparison I have is the 1929-1932 cycle. However, with the massive fiscal and monetary stimulus (and I don't believe we've seen the full extent of it yet), my best guess is a bear market contraction somewhere between the Great Depression and Great Recession. At the least, I believe we re-test lows and this bear is a 40-45% retracement from the highs. 6. **Bear markets end on the return of general price stability and strong demand for durables such as autos.** In 1949, as in 1921 and 1932, a return of general price stability coincided with the end of the equity bear market. Demand and price stability of selected commodities augured well for general price stabilization. Watch how industrial metals recover such as copper, now at the lowest levels since the fall of 2017. The Baltic Dry Index is off close to 20% so far this year. Low valuations (not there yet), when combined with a return to normalcy in the general price level, may provide the best opportunity for future above-average equity returns. We are not there. 7. **Bear markets that no longer decline on bad news are a positive.** The combination of large short positions in conjunction with a market that fails to decline on bad news was overall a positive indicator of a rebound in 1921, 1932 and 1949. Also, limited stock purchases by retail investors may be considered an important building block for a bottom. Since the worst of economic numbers haven't been witnessed yet, there remains too much hope of a vicious recovery in stock prices as well as the overall global economies.



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8. **Not all bear markets lead the economy by six-to-nine months.** Generally, markets lead the economy. However, this tenet failed to hold true for the four great bears. At extreme times, the bottoms for the economy and the equity market were aligned and in several cases, the economy *LED* stocks higher! It's unclear whether this bear behaves in a similar fashion only because of massive fiscal and monetary stimulus. We're not done with stimulus methods either. If anything, they've just begun! I know. Tough to fathom. For me and the RIA Team, every bear provides an important lesson. The beast comes in all sizes; their claws differ in sharpness. However, they are all dangerous to financial wealth. I believe the market will eventually witness a "V" shaped recovery due to unprecedented stimulus. Unfortunately, I believe the economy will remain sub-par for a long

period. Here's a vision I shared on Facebook recently: *Let me give you one example how an economy cannot turn off, then on, like a light switch. Joe's Donuts is closed. Joe lets his 2 employees go, at least temporarily. Joe employs his wife Emily to assist as she's just been laid off from her job. Joe is a quick thinker. He creates pre-packaged dough-to-go bags and sells them outside the store. His sales are off 75% as most businesses around him are shuttered. Joe was able to negotiate postponement of his rent for one month but will have to pay two months in May. Joe has a profitable business but he's already eaten through a quarter of his cash reserves to pay for supplies, maintain expenses to keep going. He can't afford another month of quarantine. The quarantine is lifted May 1 (best case scenario). Joe's establishment is open! He's hesitant to have employees return because he wants to gauge business for a month. He discovers that business is still off 40% from last year at the same time. Why? Because his patrons have either been let go or in repair of ravaged household balance sheets. In addition, he notices that purchasing boxes of donuts for office meetings is way off. Joe contacts his former 2 employees. He tells them he still doesn't require them. He's handling the traffic sufficiently alone at this time. Joe now owes 2 months of rent. He takes one month from the business' reserve account; distributes another from his retirement account. Joe's wife Ellen has been called back to work by her former employer, a local car dealership. She's been asked to work the same job, same responsibilities. However, the pay is 10% less. Out of desperation, she takes the job. Meanwhile, Joe tells Ellen that they need to find a way to continue to cut household expenses.... Well, you get the picture. I think this is reality for at least a year after the 'all clear.'* There's never been a better time to catch up on reading. Russell's book is available through Amazon. For those interested in market history, the pages hold invaluable insights. For me, markets are always battlefields, but I've survived several conflicts. Consider "Anatomy of The Bear," part of your financial literary war chest.