

# Do you see risk or opportunity?

## Learning from bear markets of the past 40 years

### DEFINING DOWN MARKETS

**Correction**—A correction is a change of momentum, typically at least a 10% reversal, that stops short of signaling a shift from a bull market to a bear or vice versa. Corrections show up when investors feel the market is over or undervalued but there aren't enough reasons in the market or economy to definitively change the definition of the market. A bull market could feature several corrections without becoming a bear market.

**Bear market**—The most common definition of a bear market is a 20% decline in security prices. Bear markets may occur in only portions of the market or vary in severity and duration from one segment to the next.

**Recession**—A recession requires two consecutive quarters of negative economic growth as measured by the country's gross domestic product (GDP). Because GDP is a backward-looking measure, recessions aren't known until after they've begun. Recessions typically are economy-wide, impacting all sectors.

#### Where are we?

As of August 31, 2011, we have not yet returned to the pre-bear peak of 1565.15. Elevated volatility, like what we've witnessed over the last few months, can distract investors from their long-term goals. However, discipline and diversification have the potential to keep investors focused.

| S&P 500 bear markets                               | S&P start price | S&P end price | % decline | % gain 1 year after bear end | Return to pre-bear peak                            |
|--|-----------------|---------------|-----------|------------------------------|--|
| <b>18 months</b><br><i>11/29/1968–5/26/1970</i>    | 108.37          | 69.29         | -36%      | 44%                          | <b>39 months</b><br><i>3/7/1972</i>                |
| <b>21 months</b><br><i>1/11/1973–10/3/1974</i>     | 120.24          | 62.28         | -48%      | 38%                          | <b>78 months</b><br><i>7/17/1980</i>               |
| <b>20 months</b><br><i>11/28/1980–8/12/1982</i>    | 140.52          | 102.42        | -27%      | 58%                          | <b>23 months</b><br><i>11/4/1982</i>               |
| <b>3 months</b><br><i>8/25/1987–12/4/1987</i>      | 336.77          | 223.82        | -34%      | 21%                          | <b>23 months</b><br><i>7/27/1989</i>               |
| <b>3 months</b><br><i>7/16/1990–10/11/1990</i>     | 368.95          | 295.46        | -20%      | 29%                          | <b>7 months</b><br><i>3/1/1991</i>                 |
| <b>28 months</b><br><i>3/27/2000–7/18/2002</i>     | 1527.46         | 881.56        | -42%      | 13%                          | <b>90 months</b><br><i>9/27/2007</i>               |
| <b>17 months</b><br><i>10/09/2007 - 03-09-2009</i> | 1565.15         | 676.53        | -57%      | 72%                          | <b>Not yet reached</b><br><i>(as of 8/31/2011)</i> |

Source: Standard & Poor's

### KEEP BEARS AWAY WITH BALANCE

Over an investing lifetime, there's no way to eliminate all discomfort while retaining the exposure to risk necessary to generate meaningful returns that can outpace inflation. Fortunately, as disciplined investors understand, while unsettling, moments of heightened anxiety also tend to signify points of great opportunity.

The difficulty of timing opportunity is complicated by the fact that most market rallies occur in brief spurts. Market

timers waiting for the right spot to buy risk being out of the market during these sudden market changes. While you have to stay in the market to capture its gains, for your emotions' sake, it's important to stay in the market with the right portfolio for you, one that is aligned with your goals and long-term expectations for risk and return.

A balanced portfolio diversified across multiple asset classes and investment styles may limit the magnitude of down markets. While individual asset classes may experience large declines, your entire portfolio may not.

## CRYSTAL BALL CLAIRVOYANCE

To benefit from market timing, you must accurately predict the future, not once, but twice. First you must correctly determine when to sell. Second, you must accurately determine when to get back in. Because falling markets can rise steeply within days, your timing must be nearly perfect.

To avoid falling into the speculator's trap, focus on the term "individual" before making any investment decision. Your individual long-term goals and your individual financial circumstances—not the daily gyrations of the stock market—should govern your decision.

By focusing on your individual needs and sticking to your investment plan, you could actually benefit from the stock market's gyrations, seeing the opportunity in them as much as any risk. Of course, changing your investments during a gyrating market is not always speculating. It can be the mark of an astute investor if the reasons for your changes are consistent with your individual long-term goals and expectations for the ongoing value of an investment.

## THE MATH OF MARKET RECOVERY

Regardless of a down market's length, it historically has taken longer for markets to recover previous peaks. This is because markets have to rise further than they fell just to break even.

| Loss | Gain needed to recoup loss |
|------|----------------------------|
| 10%  | 11%                        |
| 20%  | 25%                        |
| 30%  | 43%                        |
| 40%  | 67%                        |
| 50%  | 100%                       |

| Example                          |                         |
|----------------------------------|-------------------------|
| Initial value                    | \$100                   |
| 20% decline                      | $100 \times .20 = \$80$ |
| Gain required to return to \$100 | $25\% = 20 \div 80$     |

Recovery from significantly down markets requires long-term commitment and patience.

Remember, paper losses don't become permanent unless you lock them in with a decision to sell. Make sure your reasons for selling are consistent with your long-term investment policy.

Recovery takes even longer if you don't participate in all of it. If you invest through the trough of a market cycle, buying low, returns as markets reclaim their previous levels can accelerate the recovery of paper losses.

## Work with your financial professional to determine how your investments should be positioned to address your goals.

**Diversification and strategic asset allocation do not assure profit or protect against loss in declining markets.**

**Returns represent past index performance and should not be viewed as a guarantee of future index or investment performance.**

**Indexes are unmanaged and cannot be invested in directly.**

S&P 500 Index: An index, with dividends reinvested, of 500 issues representative of leading companies in the U.S. large cap securities market (representative sample of leading companies in leading industries).

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