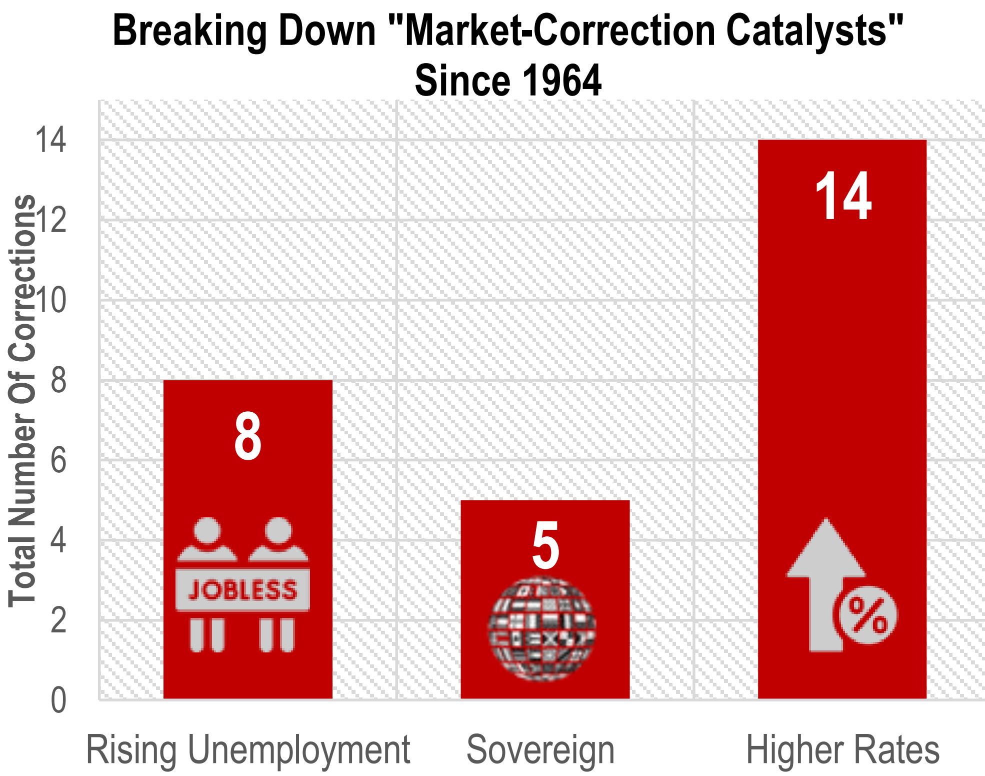
WHY DO STOCKS FALL? EXPLAINING 60 YEARS OF MARKET CORRECTIONS

There have been 27 market corrections of 10% or greater since 1964; every single one of them had at least one of three main catalysts: 1) higher rates; 2) rising unemployment; or 3) a global (exogenous) issue. Today, we see higher rates as the likeliest threat to a continued uptrend in stocks. As we wrote yesterday, we believe stocks will rally on rising recession risks (i.e., softer macro data) – certainly an unusual take! See our recent notes here and here. The S&P 500 has rallied since a peak in bond yields began in late-October of 2023. We remain constructive with the view that lower rates from softer macro data will set up stocks for another leg higher in the coming quarters. Considering today's optimistic sentiment, historically-high valuations, and recent upturn in some inflation data, there are many worried about, if not hoping for, a "healthy" market correction.

# of 10% (Or Greater) Market Corrections Since 1964

27

What Were The Key Catalysts For Each?



Other Relevant Reports:

Field Guide To Markets In NBER Recessions Click Here	**Positioning Your Portfolio For An Earnings-Driven Bear Market** Click Here	**Worried About Momentum?** *Click Here*

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Each Market Downturn Has A Primary Catalyst (Rates, Jobs, Global)

In the table below, and subsequent pages, we show all 27 market corrections of 10% or more alongside the catalyst(s) of each market downturn. We parse the downturns into three main catalysts: 1) higher rates; 2) unemployment; or 3) a global (exogenous) catalysts. Of course, each episode had it secondary and tertiary catalysts, yet we demonstrate how rates, jobs, or exogenous shocks were the main reasons that started (and ended) each correction.

Every 10%+ Market Correction Since 1964 (S&P 500)

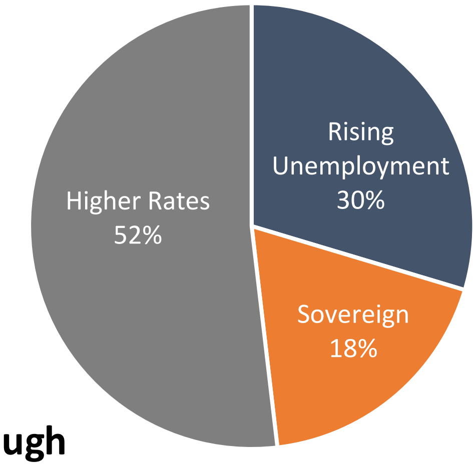
	Start	End	Drawdown	Duration (Weeks)	Higher Rates	Job Losses	Global	
1	2/9/1966	10/7/1966	-22.2%	34	X			
2	11/29/1968	5/26/1970	-36.1%	78	X	X		Recession
3	4/28/1971	11/23/1971	-13.9%	30	X			
4	1/11/1973	10/3/1974	-48.2%	90	X	X		Recession
5	7/15/1975	9/16/1975	-14.1%	9	X			
6	12/31/1976	3/6/1978	-19.1%	61	X			
7	9/12/1978	11/14/1978	-13.6%	9	X			
8	10/5/1979	11/7/1979	-10.2%	5	X			
9	2/13/1980	3/27/1980	-17.1%	6	X	X		Recession
10	11/28/1980	8/12/1982	-27.1%	89	X	X		Recession
11	10/10/1983	7/24/1984	-14.4%	41	X			
12	8/25/1987	12/4/1987	-33.5%	14	X			1987 Crash
13	1/2/1990	1/30/1990	-10.2%	4	X			
14	7/16/1990	10/11/1990	-19.9%	12		X	X	Recession/Persian Gulf
15	10/7/1997	10/27/1997	-10.8%	3			X	Asia Financial Crisis
16	7/17/1998	8/31/1998	-19.3%	6			X	Russia/LTCM Crisis
17	7/16/1999	10/15/1999	-12.1%	13	X			
18	3/24/2000	10/9/2002	-49.1%	133		X		Recession
19	10/9/2007	3/9/2009	-56.8%	74		X		Recession
20	4/23/2010	7/2/2010	-16.0%	10			X	Euro Debt Crisis
21	4/29/2011	10/3/2011	-19.4%	22			X	US Debt Downgrade
22	7/20/2015	2/11/2016	-14.1%	29			X	China, Oil Collapse
23	1/26/2018	2/8/2018	-10.2%	2	X			
24	10/3/2018	12/24/2018	-19.6%	12	X			
25	2/19/2020	3/23/2020	-33.9%	5		X		COVID/Recession
26	1/3/2022	10/12/2022	-25.4%	40	X			
27	7/31/2023	10/27/2023	-10.3%	13	X			

To See the Magnitude and Duration Of Market Recoveries ... See Page 12

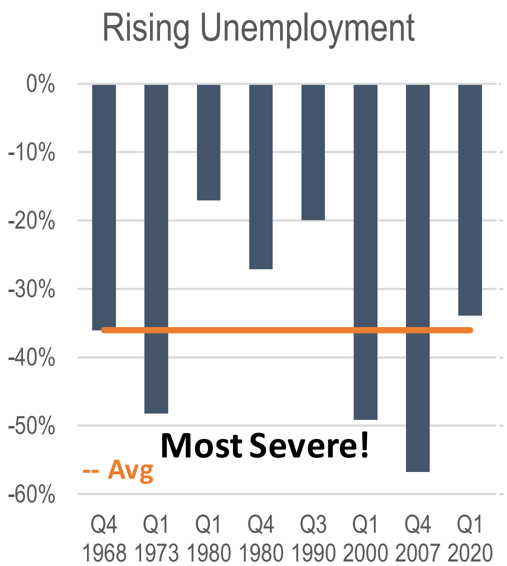
RATE-DRIVEN CORRECTIONS ARE MOST COMMON; JOBS-DRIVEN ARE THE WORST!

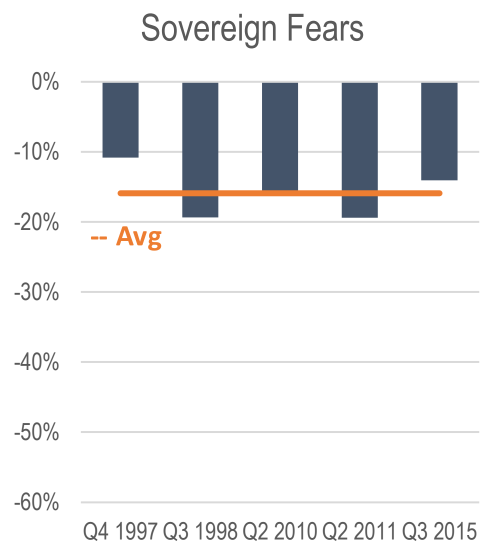
In breaking down the 27 market corrections over the last 60 years, we can clearly see that most employment-related corrections are long in duration and fall into the classic definition of a bear market (-20%+). In contrast, market corrections that are explained by higher interest rates are far more common with less severe declines over shortened periods of time. Lastly, market corrections resulting from global issues (i.e., LTCM, Thai Bhat, etc.) average around a 15% drawdown and tend to be even shorter in duration. As we consider risks to today's rally, we see higher rates as the most likely risk, suggesting a 10% correction is more likely than something worse.

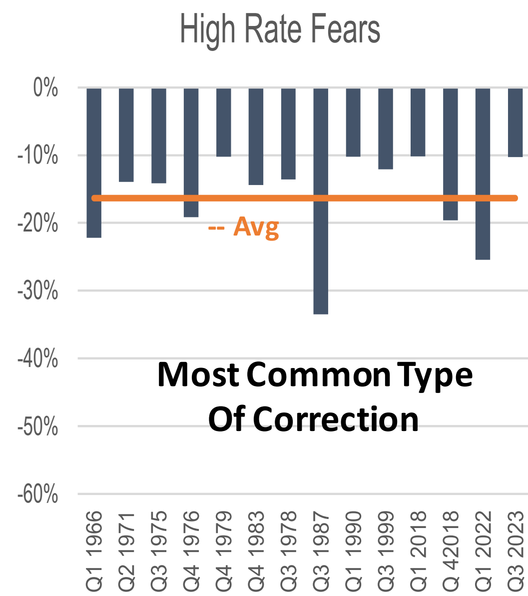
Types Of Market Corrections



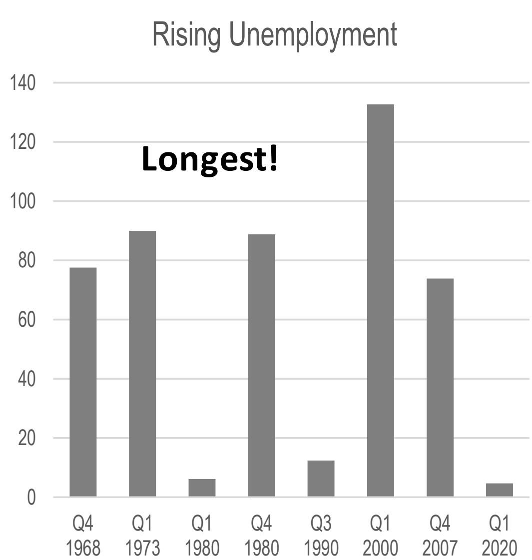
S&P 500 Drawdowns Peak To Trough

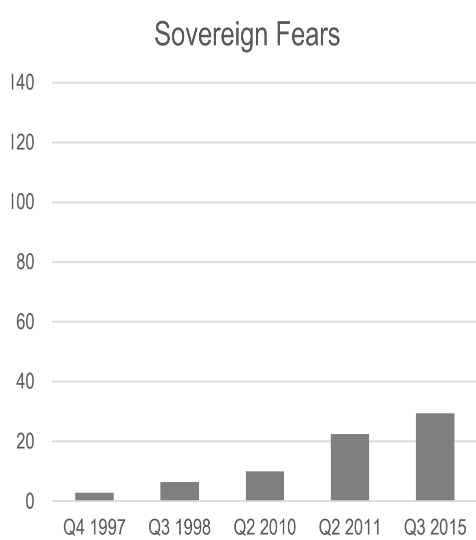


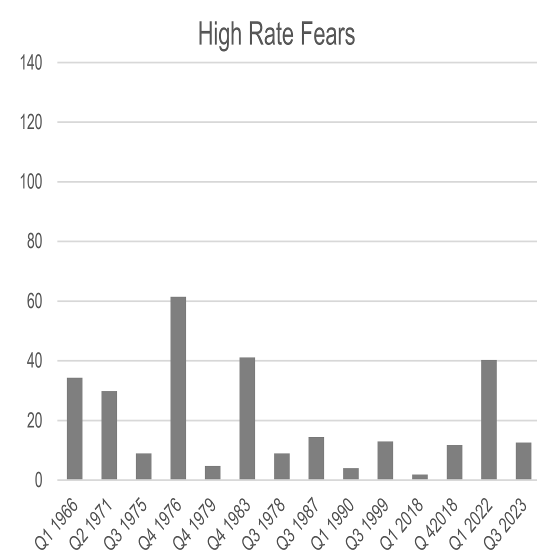




S&P 500 Drawdowns Duration (Weeks)







Market Corrections Come More From Fear (P/Es) Than Earnings

The age-old joke about the stock market "pricing in" 9 of the past 5 recessions overlooks the fact that stocks can decline for a myriad of reasons, that have little to do with imminent recession risk. Valuation changes are essentially changes in investors' perception of risk. Most market corrections since 1964 are NOT due to rising recession risks (i.e., jobs and EPS) but higher interest rates!

P/E Contraction Explains The Bulk Of Market Corrections

Peak	Trough	S&P 500 Decline	% Decline From P/E NTM	% Chg In NTM EPS
12/2/1968	5/26/1970	-33.51%	NA	NA
1/11/1973	10/4/1974	-10.23%	NA	NA
12/31/1976	3/6/1978	-19.92%	NA	NA
9/11/1978	11/14/1978	-19.34%	NA	NA
10/5/1979	11/7/1979	-12.08%	NA	NA
11/28/1980	8/12/1982	-49.15%	NA	NA
8/25/1987	12/4/1987	-56.78%	-64%	7.4%
1/2/1990	1/30/1990	-15.99%	-15%	-1.3%
7/16/1990	10/11/1990	-19.39%	-20%	0.1%
2/2/1994	4/4/1994	-14.06%	-16%	2.3%
2/18/1997	4/11/1997	-19.78%	-21%	1.7%
10/7/1997	10/27/1997	-10.80%	-11%	0.5%
7/17/1998	8/31/1998	-19.34%	-20%	0.8%
7/16/1999	10/15/1999	-12.08%	-16%	3.5%
3/24/2000	10/9/2002	-49.15%	-41%	-7.9%
10/9/2007	3/9/2009	-56.78%	-21%	-35.9%
4/23/2010	7/2/2010	-15.99%	-24%	8.0%
4/29/2011	10/3/2011	-19.39%	-24%	5.0%
7/20/2015	2/11/2016	-14.06%	-14%	0.1%
1/26/2018	2/8/2018	-10.16%	-15%	4.8%
10/3/2018	12/24/2018	-19.63%	-20%	0.7%
2/19/2020	3/23/2020	-33.92%	-34%	0.2%
1/3/2022	10/12/2022	-25.43%	-32%	6.7%
7/31/2023	10/27/2023	-10.28%	-14%	3.3%

No NTM Data Available

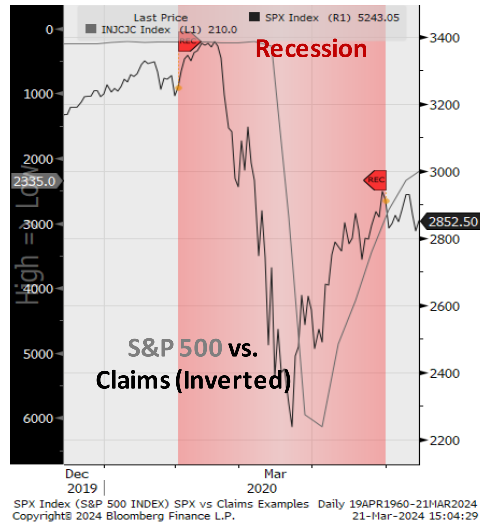
Forward Earnings Expectations <u>Rarely</u> Decline Throughout History …

… P/E Contraction Explains The Lion's Share Of Market Corrections!

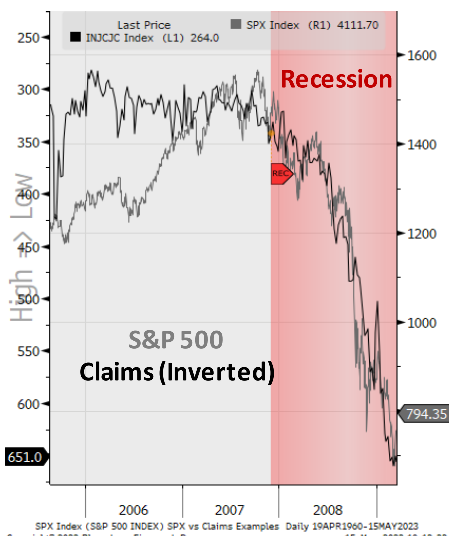
A Deeper Dive Into Employment-Driven Market Corrections

Without a doubt, the sharpest and longest equity downturns have occurred alongside employment-driven market corrections (i.e., recessions). The charts on this page show that a sharp rise in initial claims tends to be what takes down the market in recessionary periods. How sharply the market falls and how long the pullback lasts depends on many factors including the severity of the job losses and how quickly the gov't/Fed steps in with stimulus. Additionally, in some cases, when higher rates and/or high inflation was a major concern prior to the recession, a swift decline in rates or prices amidst the recession helped propel swift recoveries in equities. See recent report on the topic.

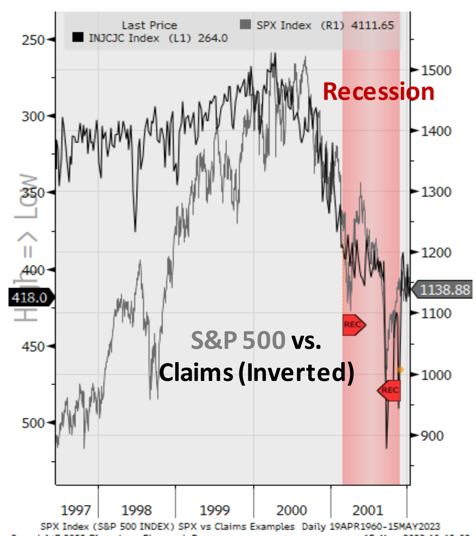
2020



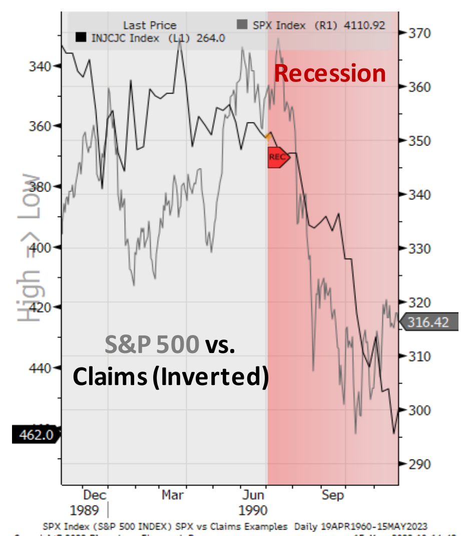
2007



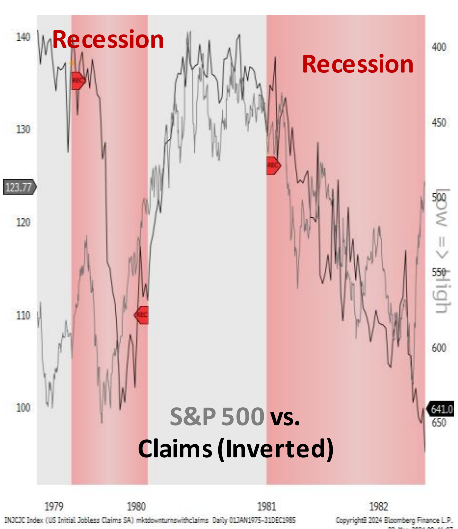
2000



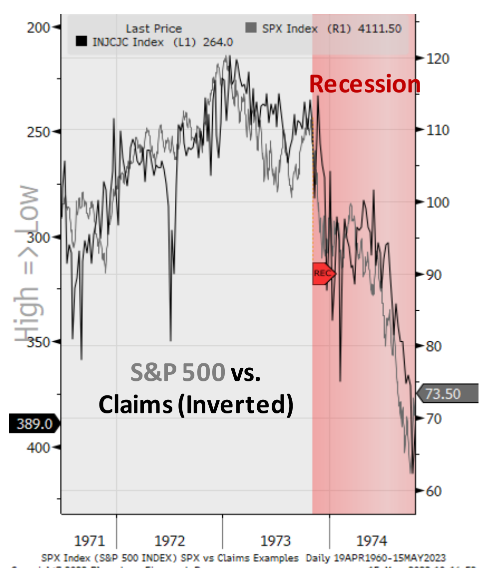
1990



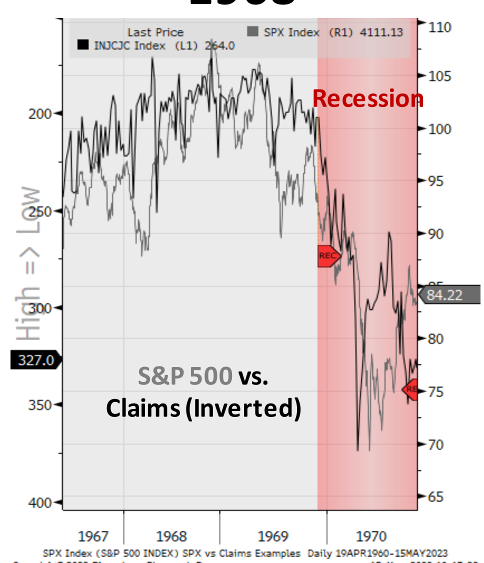
1980 & 1981



1973



1968



A Deeper Dive Into Rate-Driven Market Corrections

Going back in history, rate-driven market corrections are the most common type. Higher rates were a contributing factor to all of the market downturns in the 70s and 80s.

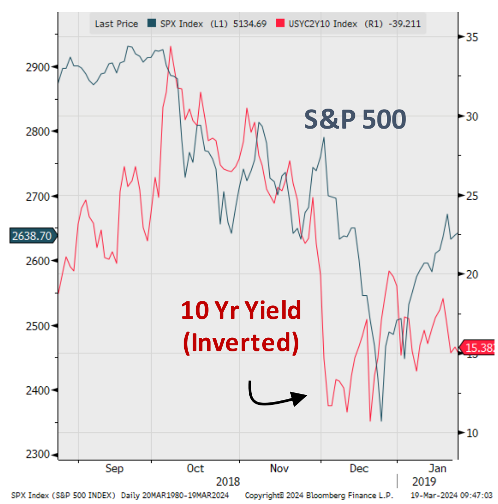
The dynamic shifted in the 90s and 2000s as a structural decline in rates and zero interest rate policies (post GFC) meant that rates rarely were the catalyst for market corrections in those periods.

In the post-pandemic world, where investors are once again focused on rates and inflation, rising rates are once again a major threat to equity markets.

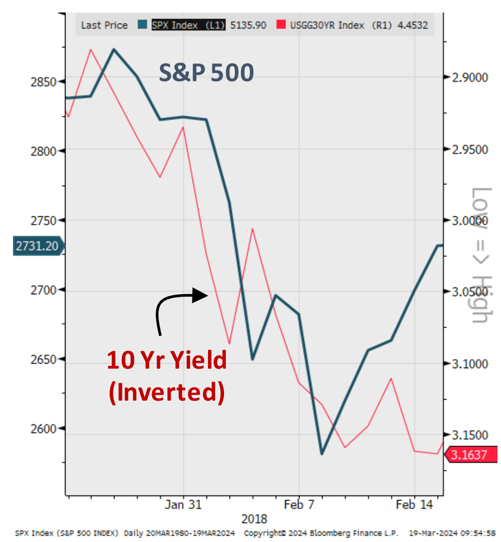
Q3 2023

2022 Q1

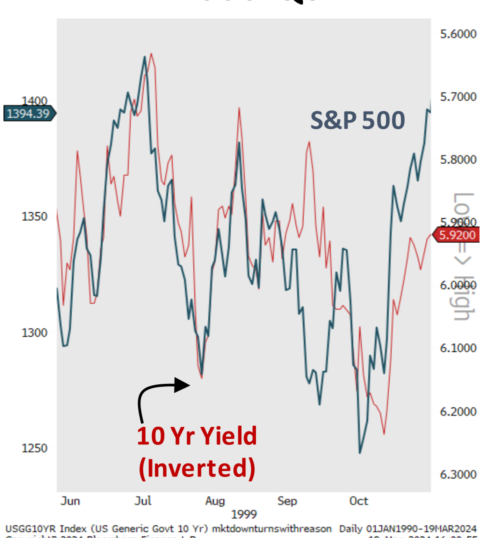
2018 Q4



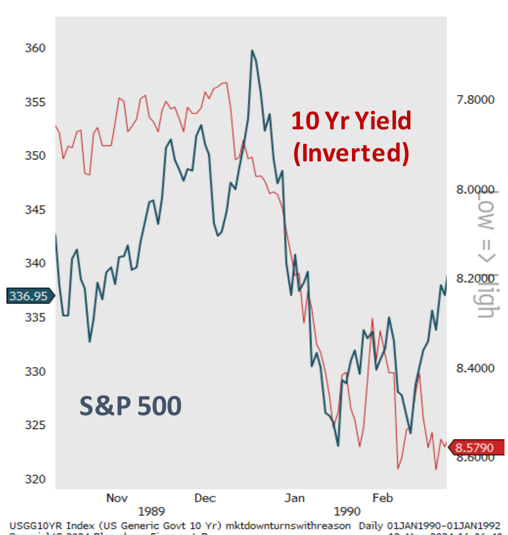
2018 Q1



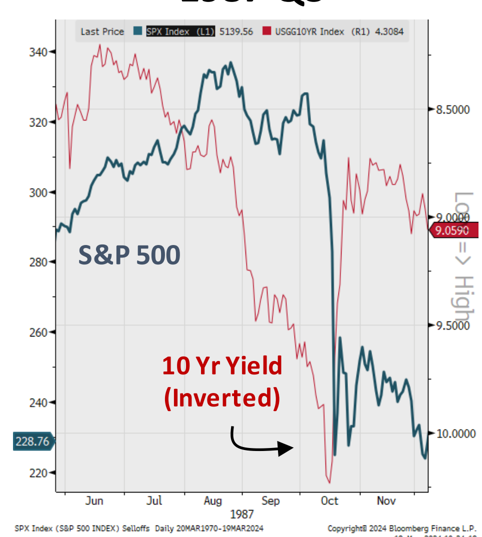
1999 Q3



1990 Q1



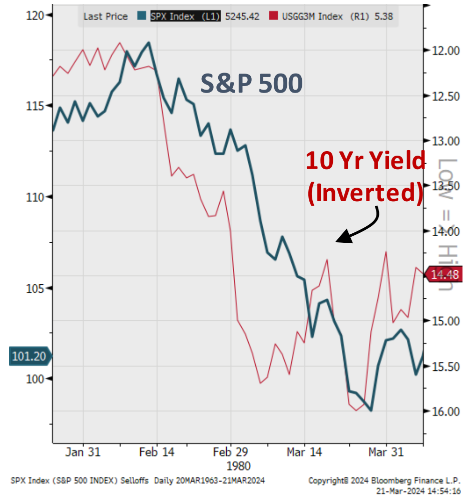
1987 Q3



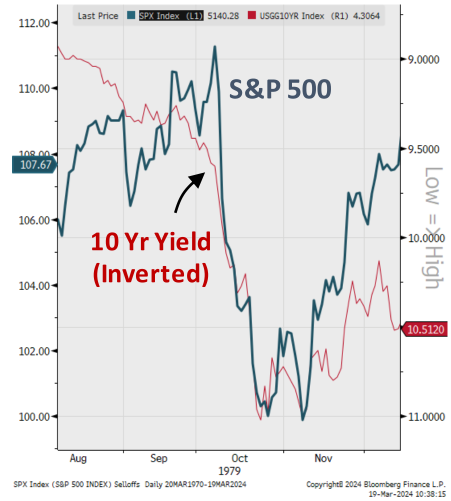
… A Deeper Dive Into Rate-Driven Market Corrections

1983 Q4

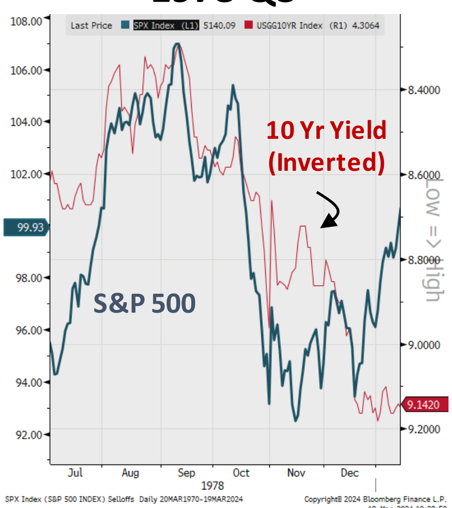
1980 Q1



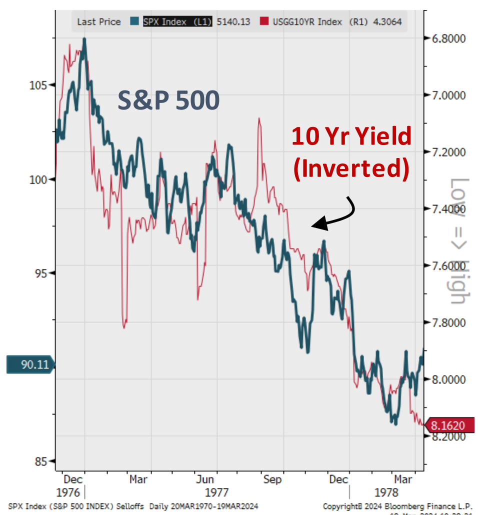
1979 Q4



1978 Q3

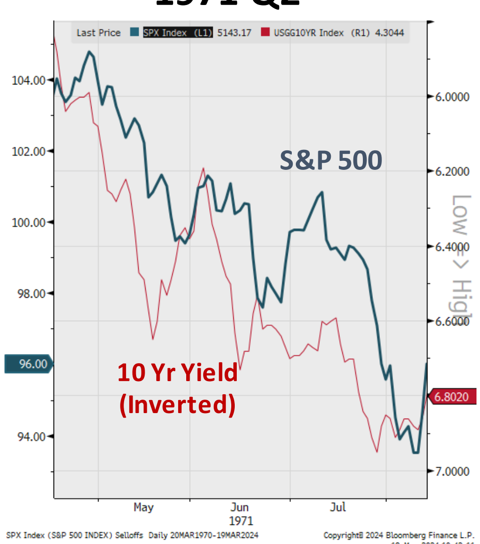


1976 Q4

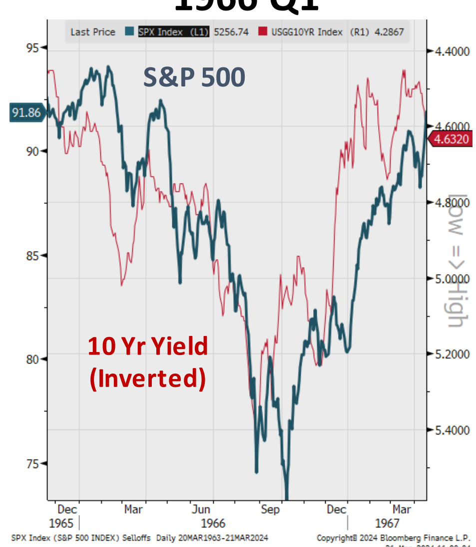


1975 Q3

1971 Q2



1966 Q1



A Deeper Dive Into Global/Sovereign-Driven Market Corrections

[2015: China/Oil Price Collapse](#)

[2011: US Debt Downgrade](#)

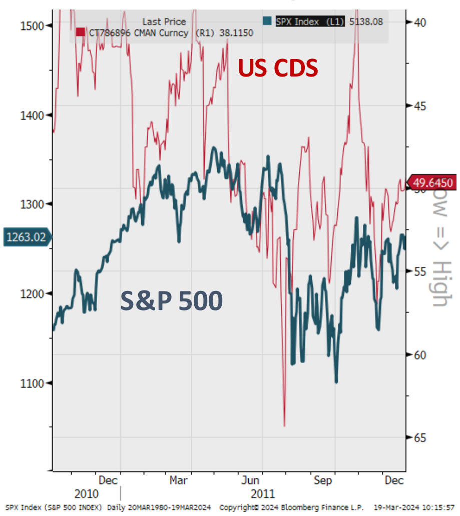
[2010: European Debt Crisis](#)

[1998: Russian Financial Crisis](#)

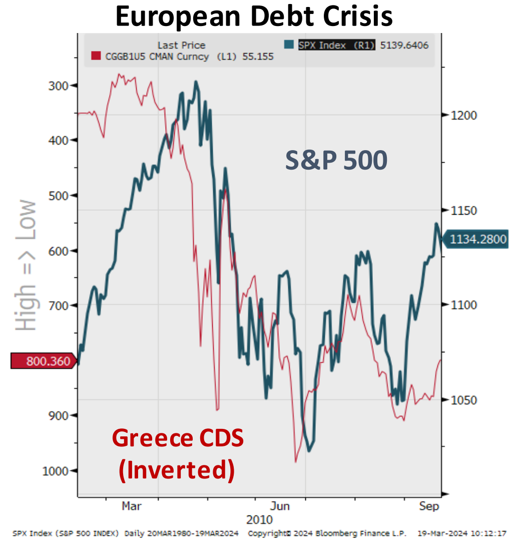
[1997: Asian Crisis](#)

2015
China/ Commodity Collapse

2011
US Debt Downgrade

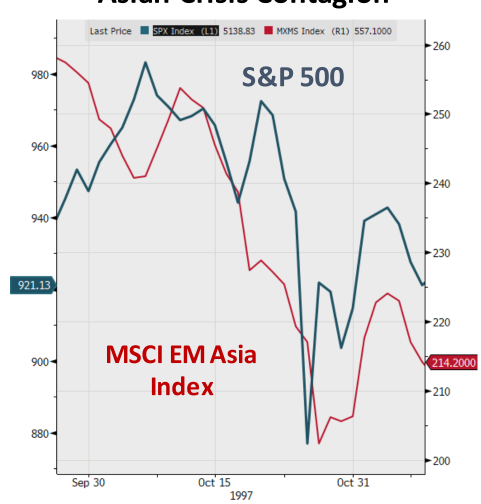


2010
European Debt Crisis



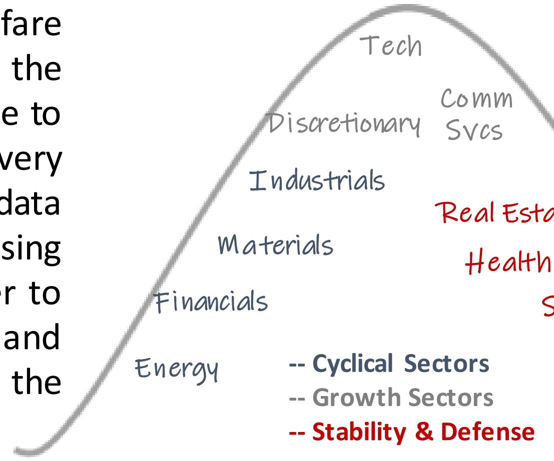
1998
Russian Financial Crisis

1997
Asian Crisis Contagion



How Did Sectors Fare In These Historical Downturns?

We always get the question of how sectors fare in market downturns and other parts of the cycle. We pulled together the following table to show relative sector performance in every market pullback (as far back as GICS sector data exists). NOTE!! There are many issues with using and comparing sectors over time. We prefer to focus on factors which are a more pure and consistent way to emphasize themes in the market. See recent note on the topic.



Sector Rotation Guide Around The Business Cycle

S&P 500 Relative Sector Returns

Peak	Trough	FIN	MAT	IND	RLST	TECH	DIS	ENR	COM	STA	HLTH	UTL
1/2/1990	1/30/1990	-3.72%	-0.60%	1.67%	NA	5.78%	-1.11%	4.56%	-6.10%	-2.30%	1.02%	2.54%
7/16/1990	10/11/1990	-13.46%	-3.53%	-8.16%	NA	-10.85%	-11.64%	14.86%	11.33%	5.82%	6.57%	16.89%
10/7/1997	10/27/1997	0.12%	-0.58%	-1.49%	NA	-5.50%	2.52%	-1.51%	4.73%	1.27%	1.67%	7.58%
7/17/1998	8/31/1998	-9.22%	0.55%	-0.32%	NA	-0.78%	-1.40%	3.92%	9.04%	2.58%	2.99%	16.83%
7/16/1999	10/15/1999	-8.43%	1.30%	-0.31%	NA	4.10%	0.70%	2.44%	2.05%	-3.22%	1.38%	3.07%
3/24/2000	10/9/2002	24.01%	24.33%	11.01%	NA	-33.22%	7.98%	30.66%	-24.93%	73.37%	42.23%	1.42%
10/9/2007	3/9/2009	-25.84%	-2.77%	-8.38%	-17.93%	3.82%	-1.24%	10.02%	6.06%	25.55%	16.90%	10.91%
4/23/2010	7/2/2010	-3.52%	-3.35%	-2.93%	2.98%	-1.22%	-2.74%	-3.84%	11.39%	7.16%	5.42%	7.96%
4/29/2011	10/3/2011	-11.74%	-9.97%	-7.37%	-1.49%	5.39%	2.91%	-9.00%	8.70%	12.53%	6.76%	18.61%
7/20/2015	2/11/2016	-8.58%	-3.49%	3.44%	5.20%	1.15%	0.59%	-8.57%	15.72%	12.20%	-3.79%	19.66%
1/26/2018	2/8/2018	-0.01%	-0.23%	0.65%	1.50%	-0.47%	1.97%	-3.88%	1.93%	1.30%	-1.53%	3.11%
10/3/2018	12/24/2018	-0.47%	0.72%	-4.53%	13.45%	-4.49%	-1.64%	-11.03%	0.92%	10.31%	4.28%	17.80%
2/19/2020	3/23/2020	-9.12%	-2.46%	-7.91%	-4.06%	2.72%	2.02%	-22.11%	5.31%	9.59%	5.87%	-1.96%
1/3/2022	10/12/2022	1.88%	2.20%	6.23%	-8.30%	-8.41%	-8.33%	66.79%	-14.74%	13.03%	12.73%	12.13%
7/31/2023	10/27/2023	-0.71%	-2.26%	-2.38%	-5.04%	0.37%	-2.86%	7.23%	2.62%	-1.12%	2.11%	-2.16%
	Average	-4.59%	-0.01%	-1.38%	-1.52%	-2.77%	-0.82%	5.37%	2.27%	11.21%	6.97%	8.96%
	Hit Rate	20.0%	33.3%	33.3%	44.4%	46.7%	46.7%	53.3%	80.0%	80.0%	86.7%	86.7%

S&P 500 Real Estate Index Data Starts Mid 2000

3 Reasons To Be Wary Of Sector Investing

Click Here For Full Report

1) Concentration Bias: A Few Stocks Can Explain The Entire Sector
Pages 2-6

2) Sectors Can Have A Diverse Range Of Macro Exposures
Pages 7-9

3) Sectors Change Over Time (Constituents, Fundamentals, etc.)
Pages 10-12

How Did Factors Fare In These Historical Downturns?

Compared to sectors, factors are a more consistent and pure way to emphasize themes in the market. Below we show how factors have historically fared throughout market corrections (as far back as factor data is available). When markets fall, stability and quality factors are the clear outperformers whereas risk factors and deep value tend to fare the worst.

S&P 500 Factor Returns (High Relative To Low, Sector Neutral)

		Risk	Variance	Deep Value	Size	Quality Value	Coverage	Profitability	Stability
Peak	Trough	Beta	Saes Variance	Sales Yield	(Small To Large)	FCF Yield	Interest Coverage	ROE	Low Volatility
8/25/1987	12/4/1987	-10.3%	-10.1%	-3.4%	-6.0%	5.0%	1.6%	4.8%	8.9%
1/2/1990	1/30/1990	-1.7%	-1.2%	-0.3%	-1.8%	0.7%	1.6%	2.6%	2.4%
7/16/1990	10/11/1990	-17.5%	-10.3%	-10.5%	-8.3%	3.9%	3.0%	8.3%	15.1%
10/7/1997	10/27/1997	-3.0%	-2.2%	0.1%	-0.6%	0.3%	1.7%	1.0%	4.2%
7/17/1998	8/31/1998	-3.1%	-5.5%	-4.2%	-5.5%	9.5%	0.8%	4.7%	9.0%
7/16/1999	10/15/1999	-0.9%	-0.6%	-9.3%	-2.3%	-3.6%	2.7%	3.0%	1.1%
3/24/2000	10/9/2002	-54.0%	-59.3%	24.2%	25.8%	87.0%	54.5%	25.9%	91.8%
10/9/2007	3/9/2009	-32.3%	-30.6%	-31.7%	-22.5%	6.0%	30.4%	45.7%	42.1%
4/23/2010	7/2/2010	-11.2%	-6.7%	-6.6%	-4.4%	-3.1%	8.3%	8.8%	12.3%
4/29/2011	10/3/2011	-21.4%	-15.8%	-16.0%	-13.0%	2.3%	15.2%	18.8%	24.0%
7/20/2015	2/11/2016	-17.2%	-14.0%	-9.5%	-7.7%	0.0%	4.9%	8.2%	18.2%
1/26/2018	2/8/2018	-3.2%	0.0%	-0.5%	-0.8%	1.0%	0.1%	-0.1%	1.5%
10/3/2018	12/24/2018	-10.6%	-5.7%	-1.9%	-1.2%	0.4%	1.0%	1.9%	8.6%
2/19/2020	3/23/2020	-15.0%	-3.3%	-17.7%	-15.4%	-3.4%	11.1%	14.1%	17.9%
1/3/2022	10/12/2022	-13.7%	-6.0%	12.0%	4.7%	5.2%	-2.8%	-1.8%	10.6%
7/31/2023	10/27/2023	-12.2%	-9.8%	1.0%	-5.5%	5.5%	4.2%	5.0%	14.5%

(Q1 vs Q5 Factor Returns, Sector Neutral)

	Risk	Variance	Deep Value	Size	Quality Value	Coverage	Profitability	Stability
Avg	-14.2%	-11.3%	-4.6%	-4.0%	7.3%	8.6%	9.4%	17.6%
Hit Rate	0.0%	6.3%	25.0%	12.5%	81.3%	93.8%	87.5%	100.0%

Most Consistent Underperforming Factors

Most Consistent Outperforming Factors

A Field Guide To Factors
An Intro To Factor Investing Around The Cycle
[Click Here For Full Report]

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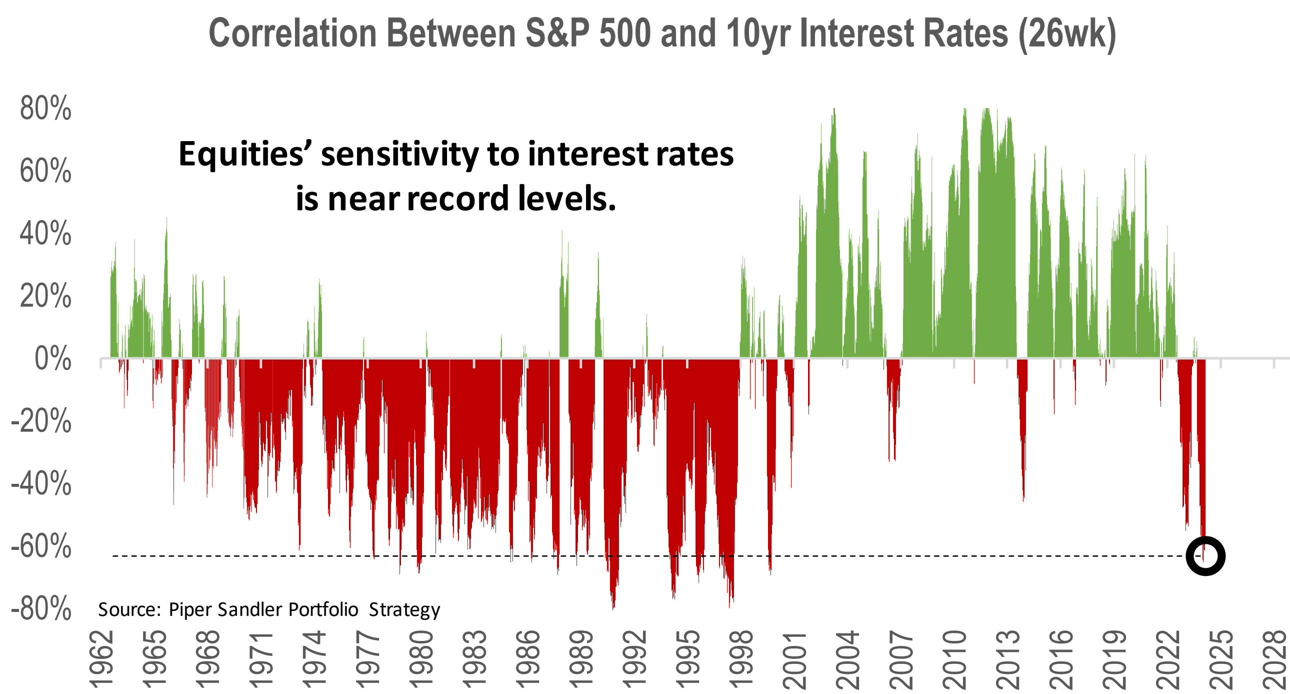
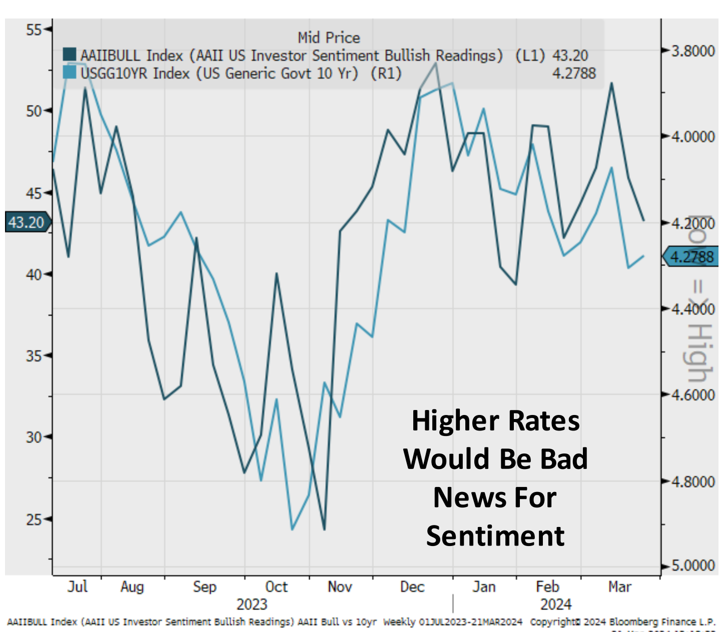
The Likeliest Risk To Equities In 2024 Is Higher Interest Rates

We've written a lot about how rate-sensitive equity markets are today. As such, the biggest risk that we see to equities in 2024 would be a rise in rates. Given the heightened rate sensitivity, slower economic growth and even a mild recession could be good for stocks if it means rates come down. See recent report for more details.

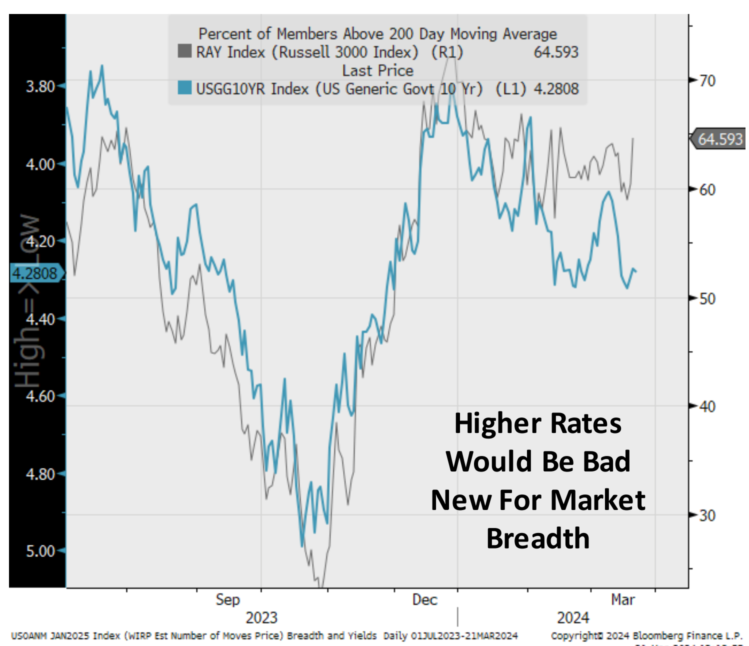
Markets Have Been At The Mercy Of Bond Yields For Over Two Years



Bullish Sentiment & Rates (Inverted)

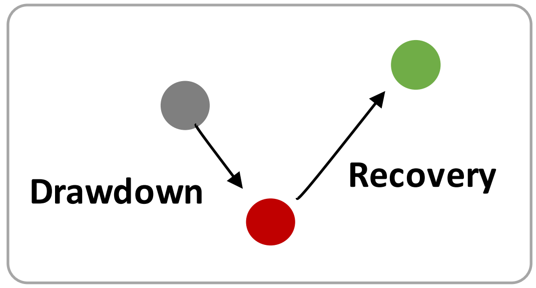


Breadth & Rates (Inverted)



A Look At All Of The Post-Correction Market Recoveries

In the table below we look at the **market recoveries** that followed all 27 of the pullbacks noted in today's report.
The duration column is essentially showing the period of time in between market corrections of 10% or more. The longest periods were in the 90s and the early 2000s where you had 365 and 261 weeks respectively without a 10% correction!



Market Recoveries Since 1965 (S&P 500)

Longest Run Without A 10% Correction!

	Start	End	Recovery	Duration (Weeks)	Higher Rates	Job Losses	Sovereign /Global
1	10/7/1966	11/29/1968	48.0%	112	X		
2	5/26/1970	4/28/1971	51.2%	48	X	X	
3	11/23/1971	1/11/1973	33.4%	59	X		
4	10/3/1974	7/15/1975	53.5%	41	X	X	
5	9/16/1975	12/31/1976	30.9%	67	X		
6	3/6/1978	9/12/1978	23.1%	27	X		
7	11/14/1978	10/5/1979	20.3%	46	X		
8	11/7/1979	2/13/1980	18.6%	14	X		
9	3/27/1980	11/28/1980	43.1%	35	X	X	
10	8/12/1982	10/10/1983	68.6%	61	X	X	
11	7/24/1984	8/25/1987	127.8%	161	X		
12	12/4/1987	1/2/1990	60.6%	109	X		
13	1/30/1990	7/16/1990	14.2%	24	X		
14	10/11/1990	10/7/1997	232.7%	365		X	X
15	10/27/1997	7/17/1998	35.3%	38			X
16	8/31/1998	7/16/1999	48.2%	46			X
17	10/15/1999	3/24/2000	22.5%	23	X		
18	10/9/2002	10/9/2007	101.5%	261		X	
19	3/9/2009	4/23/2010	79.9%	59		X	
20	7/2/2010	4/29/2011	33.3%	43			X
21	10/3/2011	7/20/2015	93.6%	198			X
22	2/11/2016	1/26/2018	57.1%	102			X
23	2/8/2018	10/3/2018	13.3%	34	X		
24	12/24/2018	2/19/2020	44.0%	60	X		
25	3/23/2020	1/3/2022	114.4%	93		X	
26	10/12/2022	7/31/2023	28.3%	42	X		
27	10/27/2023	??	27.1%	??	X		