

Reflections on Corrections

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What history tells us about pullbacks and how to navigate the ripple effects.

Key Takeaways

- Stock markets fall as well as rise, but the trend is up over the long term.
- For long-term investors, having a diversified investment plan—and sticking to it through market ups and downs—is better than selling stocks when they drop and locking in short-term losses.
- If the market pullback has shifted your target mix of stocks, bonds, and cash, consider rebalancing your portfolio back to your target asset mix. That can help position you for the eventual rebound.

After hitting new highs in February, the S&P 500® Index of large-cap U.S. stocks has fallen more than 10%, driven by concerns that the coronavirus will slow global growth and corporate earnings. That puts the U.S. stock market into correction territory.

Staying calm through market drops isn't easy, but it helps to remember that you are investing for the long term and to consider how the markets have behaved in the past. History shows that following market downturns, stocks have recovered and delivered long-term gains. And there are things you can do to stay positioned for a potential recovery, like diversifying, rebalancing, and continuing to contribute to your investment accounts.

How long and deep will this correction be?

No one can predict the timing, depth, or length of a stock market correction with certainty. What we do know is that stock market pullbacks have been a normal part of investing. Since 1920, the S&P 500 has, on average, experienced a 5% pullback three times a year, a 10% correction once a year, and a 20% decline every seven years.

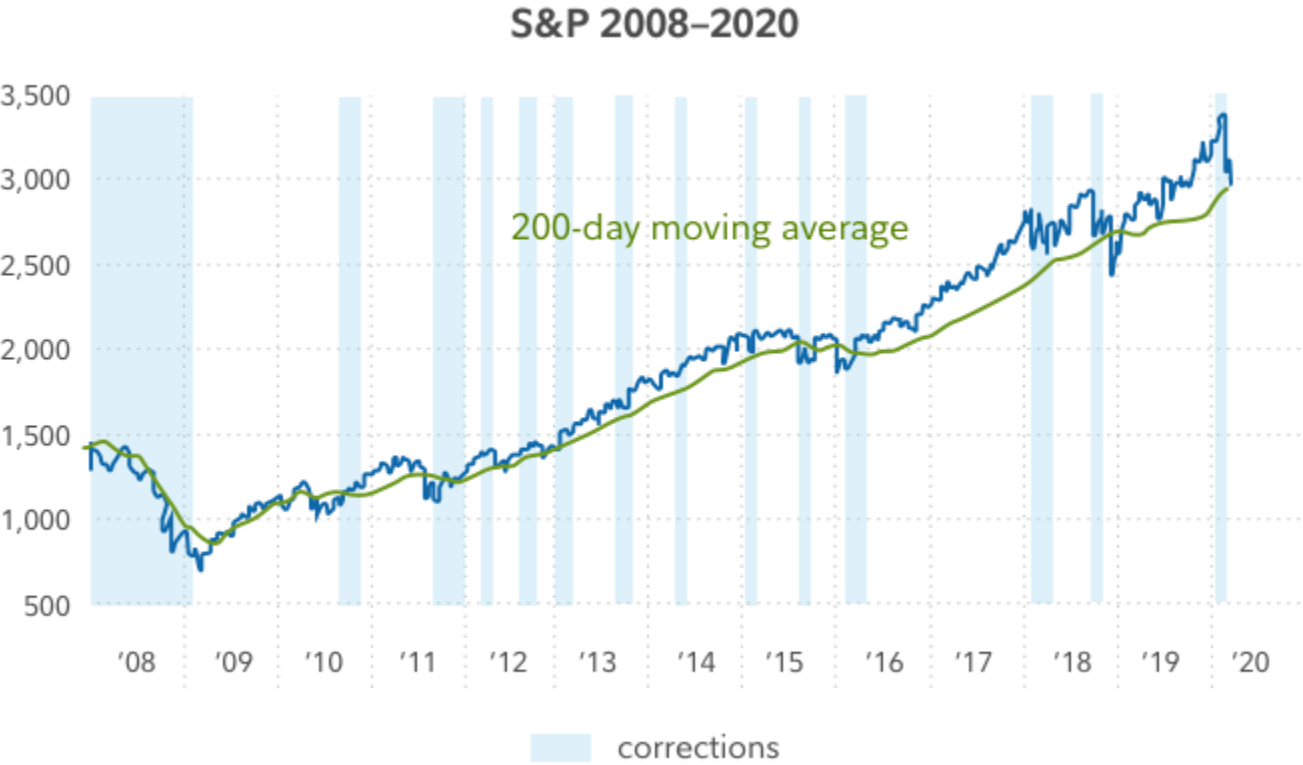
U.S. stocks and pullbacks: How deep, how often, and how long?

Depth	Frequency	Length
5%	Three times a year	44 days
10%	Once a year	114 days
20%	Every seven years	431 days

Source: Capital Group. Data reflects S&P 500, 1920-2018.

As shown in the chart below, corrections have happened somewhat less frequently since the global financial crisis in 2008, so while the recent drop may be unsettling, sell-offs of this magnitude are not unusual.

Stock market corrections and recoveries have happened regularly



Note: Corrections are declines of 10% or more, while minor ones are 5%—10% (all in blue shades above).
 Source: Fidelity Active Trader Pro®, as of March 2, 2020.

How fast will the recovery come?

It's impossible to say, given all the uncertainty surrounding the spread of the coronavirus and the ripple effects through the global economy. Nevertheless, history shows that over time stocks tend to rise, even after shocks such as the 2008 global financial crisis.

Stocks have faced virus outbreaks before such as SARS, MERS, and Ebola and have always recovered. As for the coronavirus, there are signs that cases may be peaking in China. Many governments are also using fiscal and monetary stimulus to support global growth. And unlike during the global financial crisis in 2008, the banking system is strong and inventories of unsold goods are not high. But how far the virus will spread globally and its impact on the global economy and markets is still very much an open question.

Historically, markets have shaken off epidemics

Epidemic	Month virus first appeared	S&P 500 performance +1 Month	S&P 500 performance +3 Months	S&P 500 performance +6 Months
West Africa Ebola Virus	March 2014	0.0%	5.6%	6.5%
Avian Flu (H7N9) China	March 2013	1.9%	2.9%	8.3%
MERS Coronavirus	June 2012	3.3%	11.7%	9.2%
Swine Flu (H1N1)	April 2009	3.8%	10.1%	30.1%
SARS Coronavirus	November 2002	0.2%	-7.8%	4.8%
West Nile NYC	August 1999	-5.8%	3.6%	0.6%
Avian Flu (H5N1) Hong Kong	May 1997	7.4%	11.2%	11.0%

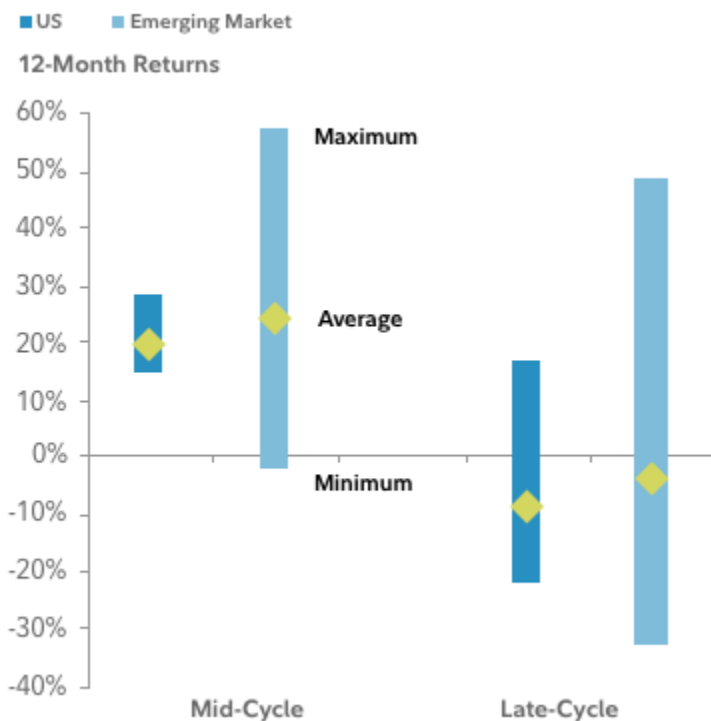
Source: Strategas as of 02/18/2020

Also, the risk that a correction turns into a bear market has historically been heightened during the late phase of the business cycle, where we are now. In only two out of six late

cycle corrections was the market able to climb back to its prior peak rather than sliding into a bear market, according to Fidelity's Asset Allocation Research Group.

Fed rate cuts have also had limited impact during the late cycle. Since 1984, the Fed has initiated seven monetary easing cycles through interest rate cuts. When the rate cuts were started during the mid-cycle phase, they consistently boosted global stocks and tightened credit spreads (the yields of Treasuries versus lower grade bonds) over the next 12 months. Rate cuts beginning in late cycle, however, resulted in a broader range of outcomes with negative average stock market returns and wider yield spreads between Treasury and lower grade bonds.

Stock returns after initial Fed interest rate cut (1984—2007)



US: S&P 500 total returns. Emerging Market: MSCI Emerging Market total returns from 1988. Source: Standard & Poor's, MSCS, Bloomberg Financial L.P., Fidelity Investments (AART) as of 9/30/19.

"In general, buying stocks amid corrections has been a good strategy in the middle of the business cycle, but it has historically been less successful during the late cycle," says Jake Weinstein, research analyst on Fidelity's Asset Allocation Research Team. "The coronavirus adds a significant degree of uncertainty during the late cycle, which is the most uncertain phase of the business cycle with respect to asset market returns."

Long-term investors: Focus on your goals

Selling stocks during a correction may be tempting, but it risks turning a potential loss into a real one. If you haven't created a diversified plan to help you reach your long-term goals,

it's a good time to meet with a financial professional. If you have a plan, it may be worth checking in to see if your investment mix is still in line with your goals. If it's off track, consider rebalancing back to your long-term target asset allocation.

Retirees: Manage your income

For retirees, who may be relying on their investment portfolio for a portion of their income, a market drop can present a different kind of challenge. If you have an income plan that is built to withstand different market conditions, you really don't need to react to a short-term market move. If not, it may be a good time to sit down with an advisor to discuss your strategy.

The bottom line

While we don't know if this pullback will be short-lived or the beginning of a bigger downturn, history shows that the stock market recovers from downturns, and most sound investment strategies are built to withstand volatility, even sharp pullbacks. If you understand your capacity to take on risk and are comfortable with your plan, there is no need to take action. If you are concerned, work with your financial advisor to build or test-drive your plan for whatever may lie ahead.

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