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Five stages of grief when losing a bull market

Margin Call: Castle Point's Stephen Bennie looks at how emotions drive a bear market.

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By **Stephen Bennie**
Tue, 05 May 2020

Castle Point co-founder Stephen Bennie

Breaking up with a wonderful partner that you thought was yours forever can be a dreadful shock to the system and can result in a period of grieving, especially if it is your first time.

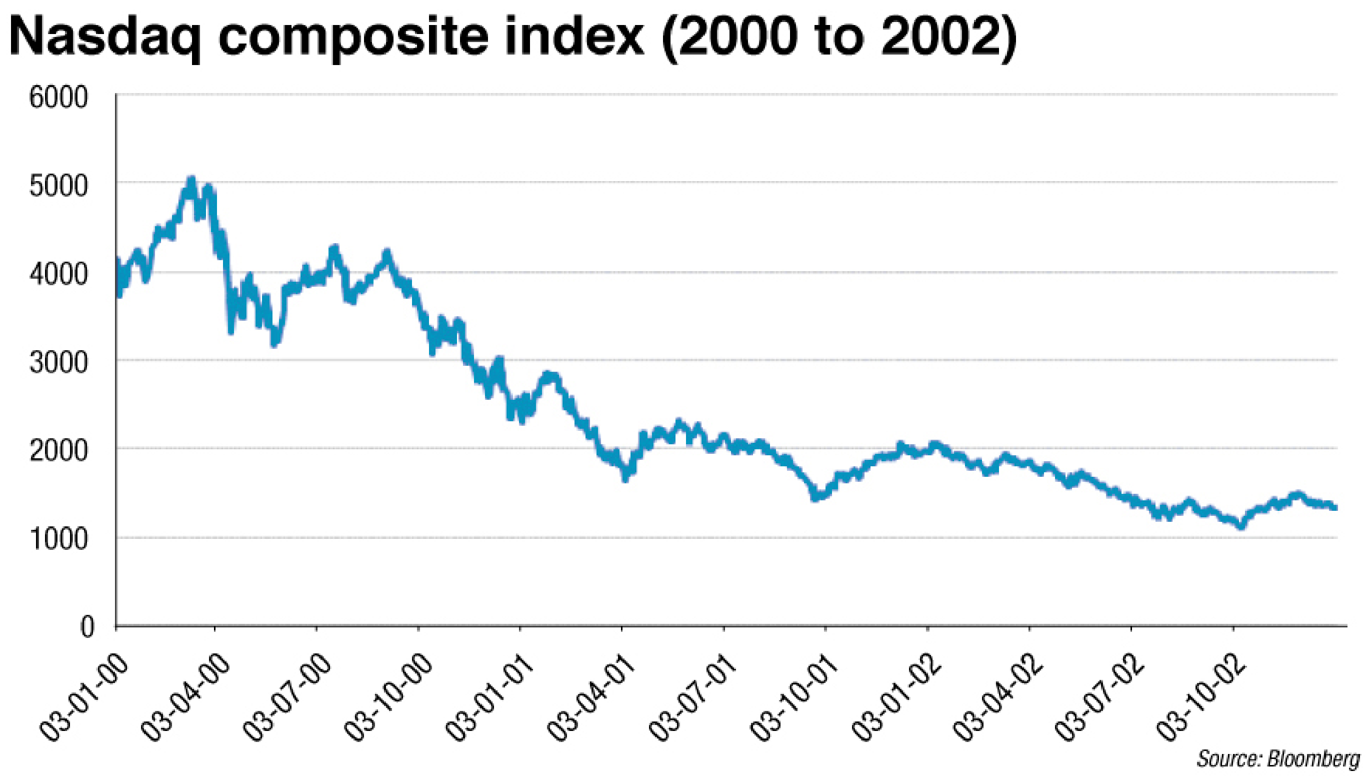
Psychologists Elisabeth Kubler-Ross and David Kessler developed the now widely accepted concept of the five stages of grief as a framework to help cope with such episodes. Denial, anger, bargaining, depression, and acceptance were the stages they identified.

Splitting up with a wonderful 10-year bull market is also traumatic and creates emotional grief, especially when your new bed fellow looks like a bear. It is entirely understandable why the initial emotion is denial. In retrospect, it seems like that was very much the mindset of the sharemarket in mid-February. Despite Covid-19 cases rapidly spreading outside China, sharemarkets around the world were setting new all-time highs. The market was siding with Trump that there would be a miracle and the virus would just magically disappear. This spell of denial was shattered when cases in Italy started to skyrocket and Europe began descending into lockdown.

Anger then set in and sharemarket sell-offs were furious in their severity. Some valuables were thrown out of windows. Value stocks were particularly brutalised. Value stocks are companies that look cheap on real metrics, such as past earnings or assets. They look cheap because they are usually out of favour due to recent performance issues. Historically, these companies get punished early in a bear market but outperform thereafter. Respected value manager GMO recently wrote an interesting white paper on this, *It's Always Darkest Before the Dawn.* GMO looks at the progression of returns from value stocks through previous bear markets.

Bargaining has now begun, with wild swings between pessimism and optimism. This is the most volatile phase of a bear market. Markets are currently weighing up the potential damage to the economy versus the enormous stimulus packages that governments around the world are signing off on. This is on top of continued uncertainty about the progression of Covid-19. Daily market price swing records are being set on both the up and down sides.

In Castle Point's opinion, the current bargaining episode looks similar to the tech wreck that began in 2000. That particular episode heralded the beginning of a recession after a wonderful decade-long bull market. You can see from the chart of the Nasdaq index, below, the index was incredibly volatile in the first six months of 2000. Wild sell-offs were followed by large and determined rallies. At one point in 2000, the Nasdaq had managed to climb 45% off recent lows.

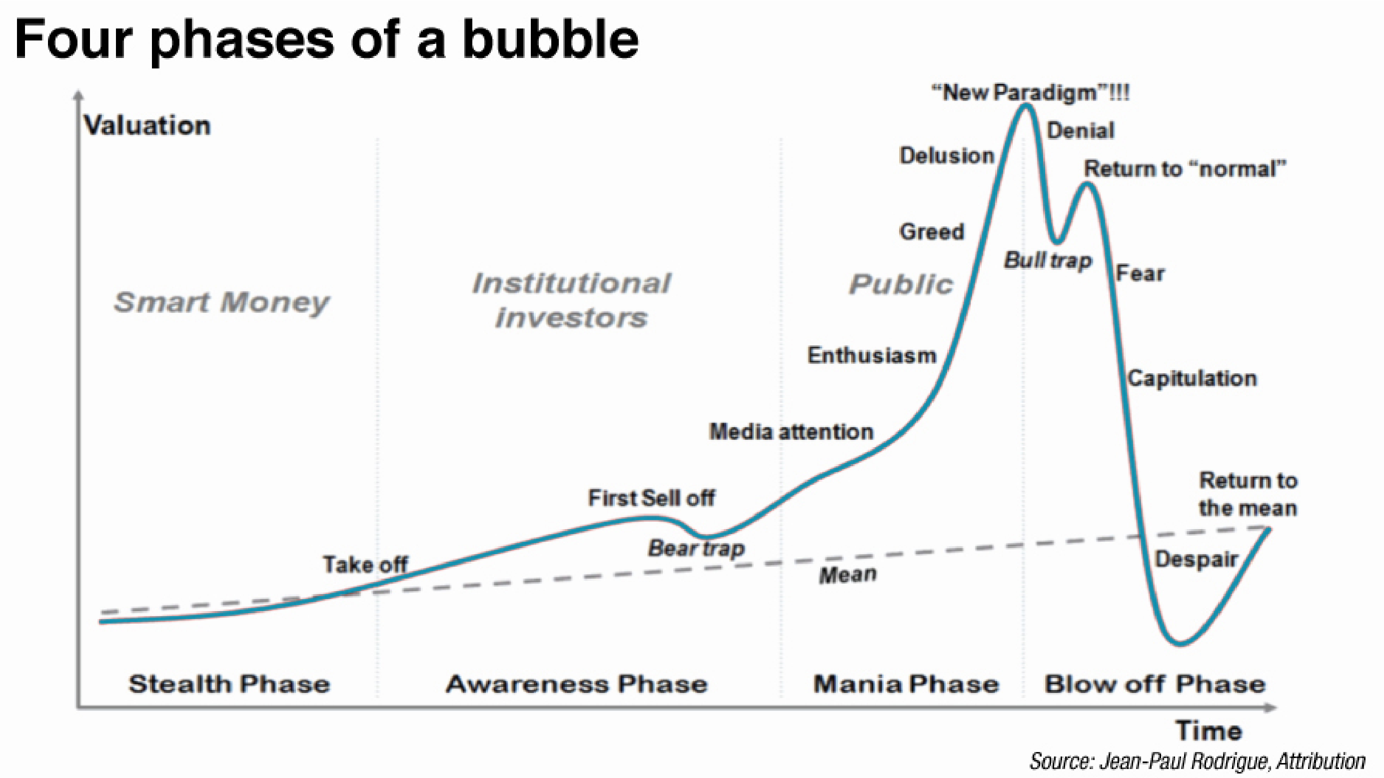


Recession then set in over the second half of 2000. Investors realised the recession was real and a broader market sell-off occurred. The Nasdaq continued to slide lower and rallies were more muted and less often as a general sentiment of depression took hold. A wonderful bull market had really ended.

Finally, in 2002, the fifth stage of grieving arrived as investors accepted the reality of the situation and moved on. This stage is the most orderly of the five. The panic has passed and investors realise they have to make the most of the situation. In the end, the actual low of the bear market is not a capitulation but an understanding that the market has entered a new phase and investors need to be thinking differently than they were three years ago.

It cannot be ruled out that the government stimulus has been sufficient, and a wonderful bull market returns to embrace us once more. Certainly, these are unprecedented events currently unfolding. You can tell how uncertain predicting has become when even the economists are saying they don't know!

But market rallies such as the one we are experiencing have historically been poor indicators of the end of a bear market. In fact, they are common during the 'bargaining' stage of a bear market and are often referred to as a bull trap. In 2008, Dr Jean-Paul Rodrigueat of Hofstra University in New York achieved notability with his model of economic bubbles, charting four 'phases of a bubble', which look closely aligned with the five stages of grief.



We are not predicting that markets will fall again but, in our opinion, the potential for further volatility is high. Some downside protection and cash to take advantage of further bouts of anger looks desirable.

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Stephen Bennie is a co-founder of Castle Point.

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rcpearson

Tue, 05 May 2020 - 6:30pm

The more simple explanation is .... when the line is going up , that's greed . When the line goes down , that's fear. !!!!

Reply

Andrew Redwood

Tue, 05 May 2020 - 11:52pm

Except that we have the problems of the “Bigger Fool Theory” driving markets up. And the fear of loosing driving the falls.

There are way too many people who try to invest based on the behavior of other investors. Rather than invest based on the fundamentals of an investment.

Reply

deekers44 Thu, 07 May 2020 - 8:51am

all perfeclty reasonable and sensible stuff - however, like 2009 govt policy throwing a wall of cash, a lot of which will make it into asset markets at some point.... I know I cant get my head around NZSX is at same level as Nov last year and yet the outlook is , well.....quite different

Reply

STREET ADDRESS

Level 3, Achilles House

8 Commerce Street

1010, Auckland, NZ

CONTACT

0800 843 627

Ph: +64 (0)9 307 1629

Fax: +64 (0)9 373 3997