The bear is back.

On Monday, June 13, investors began the week by digesting a new spate of bad – albeit familiar – news: Inflation continues to surge. In response, the markets sank swiftly and sharply, pushing the S&P 500 officially into bear market territory.[1] (A bear market, as you may remember, is a drop of 20% or more from a recent peak. In this case, the "recent peak" was all the way back on January 3 of this year.) The markets rallied somewhat on Wednesday, June 15, when the Fed announced a 0.75% interest rate increase, but the revival was short-lived. Two of the three major indices – the S&P and the NASDAQ – are officially in bear markets, and a third, the Dow, is just a short slide away.

Having helped clients navigate – and even take advantage of – several bear markets in our careers, we've found that looking solely at that 20% number can paint a picture of pure chaos in the markets. But not all bear markets are the same. Some are long, some are short. Some come with economic recessions and others don't. Some catch investors completely unawares, while others come on more gradually. For this reason, it's better to focus on the *reasons* behind the number rather than the number itself. When we concentrate on the cause instead of just the effect, suddenly a bear market doesn't seem so abstract or bewildering.

Breaking Down the Bear

This current bear market is not a surprise. It's the result of a slow, gradual market decline that's been going on since the start of the year, all driven by one thing: Inflation. In fact, the NASDAQ has actually been in a bear market since March, and the S&P 500 threatened to tip over last month before recovering somewhat after the Federal Reserve raised interest rates by a half-point. The hope was that this step – the first of its kind since the year 2000 – would start slowing inflation's rise.

Unfortunately, a half-point was not enough. On Friday, June 10, a new Consumer Price Index report showed that inflation rose even *higher* in May, to the tune of 8.6%.[2] That's the biggest increase since 1981. In essence, the Fed's half-point rate hike was like sticking your finger in a leaky dam when the water is threatening to spill over the top anyway.

That means the Federal Reserve now had a choice: Raise interest rates more aggressively and risk triggering a recession or continue on the same measured path and risk worsening inflation. (To clarify, this has been the Fed's choice for months; it's just that now, the pressure to get it right is even greater.) Both approaches come with short-term pain for the markets, which is why Friday's news was the tipping point for a bear market.

On Wednesday, the Fed announced their choice, raising the Federal Funds Rate – the interest rate that banks pay each other for overnight loans – by 0.75%.[3] That may not sound like much, but it's the biggest single rate hike since 1994, and it will lead to rising interest rates across the board. (Mortgage rates have already risen to their highest level in over 13 years.[4])

The reason the Fed did this is because higher interest rates are a proven tool for fighting inflation. Since higher rates reward saving over spending, the demand for goods and services tends to go down, forcing companies to lower their prices if they're to attract new business. Lower prices, of course, means lower inflation.

The Fed's move was expected, and many economists feel it's warranted. Why, then, have the markets continued to fall? Because now the economy is on the clock for a possible recession.

You see, higher interest rates are a double-edged sword. Higher rates mean higher borrowing costs and more expenses for both individuals and companies. If rates rise too high, too fast, it could trigger nationwide layoffs, a plunge in housing prices, and more. Given that the Fed hinted that *another* 0.75% hike was on the cards in July, such a scenario is not out of the question.[3]

When the Fed announced the rate hike on Wednesday, they also revealed something else: Their economic outlook for the rest of 2022. The Fed's hope is to achieve what's called a "soft landing." This is where economic growth slows, but a full-blown recession is avoided. There's some justification for this hope. After all, if you remove inflation from the equation, the economy is actually in pretty good shape. The unemployment rate is at 3.6%, which is *almost* back to where we were in January 2020 before COVID hit.[5] And consumer spending – the bedrock of our economy – remains strong. It was to shore up the economy that the Fed dropped interest rates in the first place. Now, the thinking goes, that mission is complete, which means it's time for the Fed to pivot to the second prong of their "dual mandate": stabilizing prices. (The first prong is stable employment.)

Unfortunately, soft landings are historically difficult to achieve, and the most recent data suggests an economic slowdown may already be happening. Consumer sentiment is dropping, retail sales numbers have dropped slightly over the last month, and while the economy continues to add jobs, it did so at a slower pace in May.[3] Even the Fed admits that the unemployment rate will likely go up over the next few years. (Moving from 3.6% to 4.1%, according to their projections.[3])

Time will tell whether a new recession is on the horizon. For now, though, fears of one have driven stocks into a bear market – and *that* is the real issue we need to concern ourselves with right now. How we handle feelings like fear will play a big role in determining how well we navigate these turbulent times.

You see, news of a bear market is an unpleasant headline in a year that's been full of them. But in my experience, the real danger during market conditions like these is not the bear itself,

but the way people *respond* to it. Because, when you think about it, headlines are written to seem *big, grand,* even *epic.* They're designed to get your attention. What they are not designed to do is give advice specific to *you.* So, let's talk about what a bear market does and does *not* mean for your investments, your financial plan, and your financial goals.

What a Bear Market Means

Have you ever been driving on the road and hit *every green light* on the way to your destination? It's a great feeling, isn't it? Well, that's sort of what a **bull market** is – and the road is the journey to your financial goals.

A bear market is the opposite.

During a bear market, the road to your financial goals, for the foreseeable future, is like getting caught at every red light in a major traffic jam. We're still progressing toward your goals, but we're inching instead of cruising. Sometimes, we may not move at all for a while. Sometimes, it may be necessary to take a detour and backtrack. It's not fun, but it's also not the end of the world. Because here's what a bear market *doesn't* mean:

Have you ever been caught in rush hour traffic, and the lane you're in won't budge? Meanwhile, the lane next to you seems to be moving fine. So, as soon as you see an opening, you merge into *that* lane – only to immediately slam on your brakes. Now the new lane is backed up! So, you try again…until you find yourself in the very lane that's closed off and causing a jam in the first place.

This is what emotional, undisciplined investors do during bear markets. They start frantically trying to change lanes, get off the road, or even abandon the car altogether. As a result, they burn fuel, waste time, and end up making the situation worse – because they aren't where they need to be when the road gets cleared and the traffic speeds up again.

They aren't there when the bear market inevitably ends, and a new bull is born.

You see, history doesn't show us how long a bear market will last. Until now, we've had three bear markets in the 21st century. The first, in the early 2000s, lasted 929 days. The second, amidst the Great Recession, lasted 517. But the third, back in early 2020, lasted only 33.[6] What history *does* show us is that bear markets are always temporary. The markets always recover – and the recovery can be a generational chance to get in the next bull market on the ground floor.

Warren Buffett once said, "The stock market is a device to transfer money from the impatient to the patient."[7] If we can remember this; if we can remember what a bear market means and does not mean, we can not only weather this volatility…but turn it to our advantage in the long run. Because while a bear market may signal the end of a bull, it does *not* signal the end of our investment strategy. Your financial plan. Or your journey toward your financial goals. Because, at the end of the day, we're prepared for this. Our car is tuned up, and there's plenty of gas in the tank.

A bear market just means we might have to sit in traffic for a while.

We will keep a close eye on what the Fed does and how the markets respond to it. Expect to hear more from us on this subject soon. In the meantime, please let us know if you have any questions or concerns about the road ahead.

Sincerely,

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