Mitch on the Markets

The 5 Biggest Stock Market Fears Debunked

By Mitch Zacks
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If there's one thing I think the market and market participants lack most today, it's *confidence.* As a Principal and Portfolio Manager at Zacks Investment Management, I spend a lot of time interfacing with the financial media, clients and prospects. A common theme I've seen pretty much all year is a reluctance to believe that the market has substantial upside left, for a variety of reasons. Over the past few weeks, I've been notating the most frequently mentioned fears and concerns, and I've compiled a list of five. Here they are:

1. **Election Fears**

No matter what your political preference, there is a lot of uncertainty floating around this election cycle. But let's forget about hypothetical "what if's" for a moment, and look at how the stock market has historically reacted in election years, and in the year following the election.

For an election year, history suggests the market should hold up just fine. In the last 22 election years, there have only been four years where the S&P 500 index finished negative:

- 1932 Roosevelt v. Hoover: -8.2% (part of the Great Depression)
- 1940 Roosevelt v. Willkie: -9.8%
- 2000 Bush v. Gore: -9.1% (part of the tech bubble bursting)
- 2008 Obama v. McCain: -37% (part of the most recent financial crisis)

As you can see, three of those election years occurred amidst fairly extraordinary economic times. So if you strip those away, history tells us that election years are almost always positive. I expect this to be the case in 2016 as well.

The next year (2017), however, may be a different story. History tells us that the year following an election year is the weakest for stock market performance, which makes sense from a theoretical standpoint—the year following an election is typically the one where the new president is most aggressive about policy setting, and the market gets agitated when there's a higher probability of regulatory changes and/or a shift in taxes or property rights. With the outcome of this election cycle too far off to call, it's also too early to start making portfolio adjustments. We'll have to wait and see.

2. The Monetary Policy Trap

In the developed world, central banks have done something that's never been done before in history—lowered interest rates to near zero across the board. In some cases (Europe and Japan), they've implemented negative interest rate policies, which essentially means that banks lose money if they keep it parked at the central bank. There are two problems with this approach. First, it doesn't seem to be working very well as banks have seen margins get squeezed, loans go up only marginally, and economic growth and inflation are currently not showing signs of taking off. Second, what happens if another financial crisis hits soon? Central banks will have already used many of their essential tools, and they could trap themselves into a corner. I actually see this as a legitimate concern in the markets today and another reason to favor U.S. stocks since the Fed has long ended QE and should be 'normalizing' interest rate policy soon.

3. The Geopolitical Threat

It often feels like the world is under siege and the threat of terror is imminent. For any readers that have been directly affected by an attack, we cannot begin to empathize with your experience. For the rest of us, we would do well to take a lesson from the market when it comes to terrorism—don't let it shake you. Apart from the September 11th attacks, there has not been a terrorist attack that has coincided with or caused a bear market. Stocks have almost always shaken off attacks within a matter of days, and even as I write here today the market continues to reach new highs, even in spite of a string of terror attacks over the last couple of years.

4. China's Economic Hard Landing

China's economic restructuring is underway, but the long-feared economic hard landing has yet to be felt. Non-manufacturing PMI (Purchasing Managers' Index) has been running well over 50 for over a year. Additionally, manufacturing PMI, which was expected to feel impact of the restructuring, has recently recovered to expansionary territory over the last few months. With consumer prices rising at a healthy 1.8% clip, and GDP still over 6%, the China fears are losing steam.

5. The Bull Market is Too Old

At 90 months, this is now the second longest bull market in history. The longest was the 1990–2000 stretch, where economic growth levels were much higher than they are now. This has many investors worried that "something's gotta give soon." But that's a weak reason to be bearish on stocks. Bull markets don't have to die of old age, there has to be a confluence of negative forces occurring that few people are talking about, and that most investors are ignoring. When you have positive investor sentiment overshadowing negative fundamentals, that's when the bull is usually ready to break. We don't have that now.

Bottom Line for Investors

With equity investing, there will always be fears and worries. The volatility in the market that accompanies these fears can often dupe investors into thinking the next bear market has arrived. But, I can tell you from my decades of experience as a portfolio manager that for every bear market, there are dozens upon dozens of "events" that analysts claim is the end of a bull, but they end up being wrong. The five concerns I've listed above, while relevant, I do not believe are powerful enough to drive the next bear market.

-Mitch

About Mitch Zacks

Mitch is a Senior Portfolio Manager at Zacks Investment Management. Mitch has been featured in various business media including the Chicago Tribune and CNBC. He wrote a weekly column for the Chicago Sun-Times and has published two books on quantitative investment strategies. He has a B.A. in Economics from Yale University and an M.B.A in Analytic Finance from the University of Chicago.