

Stock Bear Cycles

Earlier this week, a friend asked me if I thought this stock bear was over. My first thought was “which bear?”, for there isn’t just one. The stock-market action over the last couple years has been a tale *of two bears*. Investors who’ve failed to understand this critical truth are very confused on what to expect from stocks going forward.

You’ve certainly heard both sides of the bear argument. The bulls say of course the bear is over, the S&P 500 (SPX) has rallied 40% since March and 20%+ is officially bull territory. But the bears claim those lows won’t hold, that a retest is coming due to the slow economy and valuations remaining too high for a classic bear bottom in early March. Who is right? Both and neither at the same time!

The key to understanding stock-bear cycles is to realize that there are a pair of concurrent cycles, a tale of two bears. They operate like those Russian Matryoshka nesting dolls, a smaller bear cycle existing within a larger bear cycle. The larger bear cycle is measured in decades, while the smaller one nesting within is measured in years. The larger bears are known as secular bears while the smaller ones are cyclical bears.

Making this secular/cyclical distinction is absolutely crucial when using the word “bear”. If the type of bear being discussed is not explicitly specified, confusion is the inevitable result. And confusion invariably leads to poor investing decisions and loss of capital, both in a literal sense and in the opportunity-cost sense. So we need to start by defining each type of bear.

The word “secular” means long periods of time, and indeed the secular bear is well-deserving of this moniker. Throughout history, secular bears have had average durations of *17 years* each! These great bears follow great bulls, which also happen to average 17 years. One complete secular-bull-to-secular-bear cycle runs 34 years, a third of a century. I highly encourage you to read my latest [Long Valuation Waves essay](#) if you are not familiar with these great stock-market cycles. They are *crucial* to understand.

Meanwhile the smaller cyclical bears are much shorter and occur *within* secular bulls and secular bears alike. Typically a cyclical bear will average a couple years in duration. While secular bears are driven by valuations, cyclical bears are usually driven by sentiment. The former start at very overvalued levels, while the latter start at very overbought levels. This distinction may seem subtle, but it is important.

Our current secular bear started back in early 2000 because stock valuations were extreme. The US stock markets were trading at staggering prices relative to the underlying profits of the corporations the stocks represented. While the long-term average price-to-earnings ratio of the general stock markets is 14x (14

times), as this secular bear dawned the SPX was nearly triple that at 44x! This disconnect had to be addressed.

And the 17-year secular bear is the naturally-occurring market mechanism that remedies extreme overvaluation. Stocks don't fall for 17 years, but *grind sideways* for 17 years. This gives earnings time to slowly catch up with the high stock prices. As discussed in depth in [my LVW research](#), this secular bear won't end until stocks reach deeply undervalued levels (7x earnings, half the average) out in 2016 or so.

So from a valuation perspective, today's secular bear is indeed only half over. Over the next 8 years, the stock markets are very unlikely to get materially higher than their early 2000 and late 2007 levels at best. This is around 1550 on the SPX. Investors are indeed wise and prudent to respect this secular bear and trade accordingly. But an overarching 17-year sideways grind certainly doesn't mean they should totally avoid stocks in a secular bear.

We mortal humans really don't live very long. And our useful investing lifespan is considerably shorter than our natural ones. To invest, first surplus income has to be generated. For most people this starts happening a few years after college, say at 25 years old. Investment can continue as long as someone can live below their means and keep plowing surplus income into the markets. But once retirement arrives, say at 65, working income stops so investments must then be gradually sold to finance life.

With an average investing lifespan of just 40 years, investors can't afford to let their surplus labors sit in idle cash for 17 years. This is especially true in the Fed's fiat-currency regime where [dollar inflation](#) is constantly eroding our saved purchasing power. Thus a good steward of his assets invests all the time, not just when the sun is shining. While it is much harder in a secular bear, investing can still bear great fruit.

And this is where cyclical bulls and bears come in. Within the 17-year secular trends, every few years or so the short-term trend changes from bull to bear or back. These cyclical swings can be wildly profitable. Within a secular bear for example, a cyclical bull often leads to a 100% gain in a few years or so. Then the subsequent cyclical bear often leads to a 50% loss over a similar span. These big moves are very tradable.

This first chart illuminates the stock-bear cycles by examining our current secular bear compared to the last one that straddled the 1970s. Within both secular bears, 17-year sideways grinds, major cyclical bulls and cyclical bears erupted. The secular bears form giant sideways trading ranges while the cyclical bulls and bears meander back and forth within these ranges. Investors need to understand this behavior.



The red line follows the S&P 500 during the infamous secular bear from 1966 to 1982. Note that even though stocks simply traded sideways on balance over this 17-year span, it wasn't randomly. Multi-year cyclical bulls and bears emerged that were quite tradable by investors and speculators alike. They could buy low near the bottom of the secular trend and sell high a few years later near the top. And instead of just sitting out cyclical bears the speculators could actively short them, as we've done at Zeal.

We've seen similar behavior in our current secular bear, the blue line. Since 2000, the stock markets have just ground sideways on balance. Yet within this giant secular trading range mighty cyclical bulls and bears have emerged. From March 2000 to October 2002, the SPX fell 49% in a cyclical bear. But out of those oversold depths a new cyclical bull emerged that carried this index 102% higher by October 2007.

Yet even after such a strong cyclical bull, the SPX couldn't materially exceed its 2000 highs since it is stuck in a secular-bear trading range. So from its late 2007 heights another cyclical bear emerged. This one dragged the SPX down 57% by March 2009, once again carrying it to the bottom of its secular trading range. These doublings in cyclical bulls followed by halvings in cyclical bears are common within secular bears, as these are the exact magnitudes of swings that keep the giant secular trading range intact.

As I argued right in the darkest days of the stock panic back in November, the SPX being near its secular support strongly suggested a [new stock bull](#) was being born. Why? This is how secular bears work. They are not 17 years of

falling prices, but 17 years of sideways grinding punctuated by a serpentine meandering cyclical-bull-then-cyclical-bear cycle. Companies and stock markets don't cease to exist just because people are scared, life and the economy always march on.

One of the primary arguments *against* the new-cyclical-bull-within-secular-bear thesis at both the November and March lows was valuations. How could the stock bear be over when valuations were well above the 7x earnings classic bear-low metric? This really amused me, as I have been studying valuations [since 2001](#) when I predicted this secular bear. All of a sudden 7 years later, valuation studies became the new rage. Yet sadly they were superficial and usually misinterpreted.

This next chart explores valuations in secular bears by zooming in to the same span shown above and noting the SPX P/E ratios at key turning points. If you carefully study this chart, it utterly shatters the popular notion among traders today that a stock bear can't end until we see 7x earnings. While a *secular* bear won't end until such low valuations are seen, cyclical bears can end regardless of where valuations happen to be because valuations are not what drive these cyclical moves within secular trends.



In the last secular bear that ended in 1982, general stock valuations did indeed fall under a P/E ratio of 7x earnings. But it didn't happen until *17 years in!* In October 1966, the SPX bottomed at 18.8x earnings and then rallied 48% by November 1968. In May 1970 the SPX bottomed again at 13.8x earnings, still way above the 7x metric. Yet out of those "overvalued" lows a strong 74%

cyclical bull emerged that ran until January 1973. And this pattern goes on and on if you follow the red line above.

The key point is that cyclical-bear bottoms within secular bears don't require any certain P/E-ratio level. That is a misleading myth propagated by sloppy analysts too lazy to actually study market history. Cyclical bears bottom when stocks get too oversold near the bottom of their secular-bear trading range, it has nothing to do with valuations. The best example of this ironclad truth is from our current secular bear.

Back in October 2002, the SPX was down 49% in its first brutal cyclical bear of this secular bear. Trading near 775, it wasn't much higher than we saw during the recent stock panic. It was this late 2002 low that established the secular trading range that the SPX has largely stuck to ever since. But note that at those 2002 lows, the stock markets were still trading at 25.5x earnings. These are *very high* valuations, almost into classical bubble territory of 28x (twice 14x fair value)! Yet the next cyclical bull was still born.

Between October 9th, 2002 and October 9th, 2007, the SPX blasted 102% higher in one of the longest cyclical bulls I've ever come across. Yet after this run, after more than doubling in exactly 5 years, the valuations at the late 2007 top (21.3x) were substantially *lower* than at the late 2002 bottom. This is about 1/6th lower even though the SPX was over twice as high! This illustrates an extremely important point.

Time is the primary weapon secular bears use to revert prevailing valuations back from very overvalued levels at the start of the secular bear to very undervalued levels at its end. As the years pass by, corporate earnings naturally grow. And since stock prices are trading sideways on balance, the P/E ratios naturally gradually contract. Like a child growing into shoes that are still too large, earnings grow into prevailing stock prices. Big cyclical bulls and bears within secular bears do not short-circuit this overriding strategic valuation-mean-reversion trend.

The farther you progress into a secular bear, the more valuations moderate at both cyclical tops and bottoms. If you look at the peak-to-peak or trough-to-trough P/E-ratio comparisons above, in either secular bear, you will note they are always contracting over years. But at any given cyclical top or bottom, they can be anywhere. Like stock prices, earnings are in constant flux over the short term which leads to occasional valuation anomalies. But over time, the secular bear will force P/E-ratio contraction.

Realize that today's bearish arguments stating that 7x earnings wasn't hit in March, so therefore today's stock markets can't be in a new bull, are totally specious. Anyone advancing this 7x thesis does not understand stock bears and has not studied them. Major and very profitable cyclical bulls can erupt within

secular bears from all kinds of valuation levels. 7x earnings are not seen until *the very end* of a secular bear!

Out of extremely oversold (a function of sentiment, not valuation) lows, near the bottom of the secular-bear trading range, massive cyclical bulls erupt. Prudent investors can ride these to 100%+ gains in the general stock markets and much bigger gains in sectors outperforming fundamentally like [commodities stocks](#). Despite remaining in a secular bear today, we are due for a huge cyclical bull that should run for several years or so. Valuations are irrelevant for this already-underway surge higher.

To get a better understanding of the kinds of speed and magnitude a young cyclical bull can command out of the bottom of a secular trading range, consider the 1974 and 1975 example. This next chart zooms in to the early 1970s and compares it to the matching years in our current secular bear. Occurring at the exact same point in two separate secular bears separated by an entire 34-year LVW cycle, the similarities between 2008 and 1974 are uncanny.



While 2008 was the first full-blown stock panic [in 101 years](#), 1974 was certainly no picnic. Instead of plunging 27.1% in less than 4 weeks like the SPX did in October 2008 at the worst stage of our recent panic, the SPX plunged 24.6% in 8 weeks leading into October 1974. That selloff wasn't quite at panic-type speeds, but it was certainly of panic-type magnitudes. Investors were terrified in late 1974 just like they were in late 2008.

And the economy wasn't looking so hot then either. Today investors worry about a simple mean-reversion in house prices from bubble-like highs, but back then there were gasoline lines and rationing. The Arabs were using oil as a weapon to try and punish Americans for US support of Israel after Egypt and Syria simultaneously invaded it to try and wipe out the Jews. In 1974, headline CPI inflation ran 12.3%! In the first quarter of 1975, the US economy contracted at a sharp 4.8% annual rate. Things were a mess.

Despite these huge economic problems that were far more disruptive than today's credit crunch, the stock markets still rallied out of those deeply oversold October 1974 lows. By July 1975, the SPX was already up 54%. And by September 1976, this cyclical bull within a secular bear had carried it 73% higher. And as you can see above, the sharp initial ascent of this cyclical bull in its first 9 months or so was virtually identical to what we've seen in the SPX since March 2009. Cyclical bulls within secular bears are awesome beasts!

And provocatively, this particular cyclical bull we've entered today has much greater potential than the one that erupted after the near-panic in 1974. The biggest up years ever witnessed in stock-market history happen immediately after the biggest down years. While 1974 was down 30%, 1975 rallied 32%. And 2008's 38.5% SPX decline was the biggest calendar-year plunge in this index's entire history. So over a century of [stock-market history](#) spanning panics and a depression strongly argues that 2009 is going to be a *huge* up year. This post-panic reversion force will probably make this cyclical bull much bigger and faster than normal.

As in 1975, the state of the economy today is largely irrelevant for this unfolding stock bull. Stocks are not rallying because they are fundamentally cheap, nor because the economy is improving. They are rallying simply because they were far too radically oversold in the stock panic. The SPX near 750 in late November or 675 in early March was handicapping the end of the world, yet that obviously didn't come to pass. So stocks have to be bid *back up* to reasonable levels reflecting a severe recession, not a depression. And of course sentiment has to be rebalanced away from the extreme fear of the panic.

The *secular* bear that started in 2000 is indeed alive and well. We are only about halfway through its 17-year span. Still, coming out of the bottom of its secular trading range a mighty *cyclical* bull has erupted. This should lead to a 100%+ total gain in the SPX over the coming years. There is absolutely no contradiction in this cyclical-bull-within-a-secular-bear worldview. It is coherent, logical, and historically sound.

At Zeal we have been actively trading this thesis since the stock panic, to big gains. As I mentioned last week in my latest [controversial inflation essay](#), our new long-term investments added in the heart of the stock panic already have average unrealized gains over 100%. Our 29 open post-panic stock trades in our

[monthly](#) and [weekly](#) subscription newsletters now have average unrealized gains approaching 50%. The opportunities are vast early in this cyclical bull. Can you afford to miss them after the panic, to let inflation ravage your cash and your future lifestyle?

As zealous students of the markets, we are dedicated to relentlessly studying them and applying this research to recommending high-potential investments and speculations to our subscribers who support our work. We called that latest brutal cyclical stock bear [in January 2008](#) when the SPX was at 1350. We called this new cyclical stock bull [in November 2008](#) in the heart of the panic. If you want to grow your knowledge of the markets, and profit greatly from it, [subscribe today!](#)

The bottom line is there are two types of bears, secular and cyclical. While we are only halfway through a 17-year secular bear, the last *cyclical* bear just gave up its ghost in early March. It wasn't an undervaluation that signaled this end, as that classic 7x earnings standard only applies to secular bears. It was the extreme oversoldness and extreme fear, which weren't sustainable. Stocks were simply driven too low in the panic.

And they are due to rally greatly because of this oversold anomaly. A new cyclical bull has been born. There is no contradiction at all in being long stocks during a cyclical bull within a secular bear. It is actually the most prudent course for growing capital. But sadly only the investors and speculators who take the time to learn about stock-bear cycles will be able to capitalize on these awesome opportunities.

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So how can you profit from this information? We publish an acclaimed monthly newsletter, [Zeal Intelligence](#), that details exactly what we are doing in terms of actual stock and options trading based on all the lessons we have learned in our market research. Please consider joining us each month for tactical trading details and more in our premium Zeal Intelligence service at ... www.zealllc.com/subscribe.htm

Questions for Adam? I would be more than happy to address them through my private consulting business. Please visit www.zealllc.com/adam.htm for more information.

Thoughts, comments, or flames? Fire away at zelotes@zealllc.com. Due to my staggering and perpetually increasing e-mail load, I regret that I am not able to respond to comments personally. I will read all messages though and really appreciate your feedback!

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