LAWSON KROEKER
INVESTMENT MANAGEMENT

As We See It

Stock Market Corrections

Stock market corrections have been a market phenomenon for as long as stock markets have existed. Corrections appear periodically and help the market catch its breath before going on to higher levels. The problem is that no one knows when a correction is going to rear its head and interrupt the euphoric upswing experience of a bull market.

While there is no specific definition, it is generally accepted that a *bull market* is an *increase* of 20% or more in the Standard & Poor's 500 Index. By the same token, a *bear market* is a *decrease* of 20% or more in the S&P 500. A *correction* is a price decline of at least 10%—but no more than 20%—within a bull market. A correction is sometimes referred to as a secondary trend because it takes place within the primary trend of the bull market. There is no time limit for a correction to play out. A correction can last for a few days or months. It is purely a price change.

In a healthy, long-term bull market corrections are part of the process. They take place for a number of reasons including profit taking by short-term traders, foreign market actions, or simply the actions of our own government.

Since 1928 there have been a total of sixty bull-market years with twenty-two corrections within that time period. This means the market declined at least 10% twenty-two times without subsequently falling into bear market territory. So with history as our guide, we can expect a market correction, on average, every 2.7 years.

Since the current bull market began in March 2009, there have been 2 corrections to date—one of –16.0% in 2010 (where the S&P 500 fell from 1217.28 on 4/23 to 1022.58 on 7/23) and another scarier correction of –19.4% in 2011 (where the S&P 500 dropped from 1363.61 on 4/11 to 1099.23 on 10/03). Since then, there have been no corrections, although the 10% threshold has come close to being breached more than once.

If and when you see the market has dropped 10% or more, how can you tell whether it is a normal correction or if it has turned into a bear market? The only way you can really tell whether you are experiencing a correction or the end to a bull market and beginning of a bear market is by looking at the fundamentals.

By fundamentals we are referring to the *things* or *basics* that can have a long-term impact on securities' prices. The economy is one of the best fundamental indicators if a person can wade through the government statistics and (mis)information to figure out, at best, the direction it is headed for the next several years. Another fundamental indicator to watch is the Federal Reserve. Normally, when the Fed is easing, that is a sign that the bull market is intact and any pullback is likely to be a correction. But when the Fed is beginning to tighten due to an overzealous economy or overdone credit expansion, it is probably a signal of an upcoming recession and a bear market.

Regardless if a market downdraft is a correction or eventually turns into a bear market, the only thing that really matters is the earning power of the companies we own. If one is an acquirer of stocks, a correction should be welcome as additional stock can be bought for less. If one happens to be retired and a net seller it becomes very important to pay close attention to valuation. That which is very expensive (or overvalued) should be sold and that which is cheap (or undervalued) should be purchased.

July 2013

450 Regency Parkway, Suite 410 | Omaha, Nebraska 68114-3701 | *tel* 402.392.2606 | *fax* 402.392.2597 | www.lawsonkroeker.com