Stock Market Perspective: Long Time, No "Correction"

Wall Street commentators love to have supposedly meaningful terms to describe the movements of stock prices. One of them is that a drop of 10% in a major index is considered to be a "correction." I find the term amusing because it implies that something is wrong that needs correcting. Why higher stock prices are a problem, unless one is short or owns put options, mystifies me. The drop starting late January was less than 10%, so it did not meet the "official" definition. Based on the weekly closes, the S&P 500 fell by not quite seven percent. For convenience, I use the weekly closing values of that index in what follows.

It has been over a year without a 10% correction. The end of the run may be a warning of lower stock prices to come.

As of April 16, we have gone 58 weeks without seeing a 10% decline in the S&P. How does that stack up with the index's historical behavior? Since the beginning of 1960, there have been fourteen longer intervals without a correction. The shortest of those was 61 weeks. Interestingly, the one just below it was only 41 weeks, so the current run is in a distinctive class of ones that have lasted for more than a year. Eight of the fourteen lasted one to two years with the longest of these being 101 weeks. There is another gap up to 141 weeks. The three longest lasted more than four years. The one ending in August 1966 went 215 weeks, the one finishing in January 2008 was 257 weeks, almost five years, and the granddaddy of them all went for 417 weeks, eight years, until August 1998. That one was in the midst of the incredible secular bull market in 1982-99.

We see that runs without a 10% drop in the S&P lasting more than a year happen every few years. Since it would take only another three weeks to match the 61 weeks (ended in October 1999), the current run has a good chance of moving above the shortest of the over one year group.

The more interesting issue is what happens after one of these long runs without a 10% drop finally ends. Does the S&P do better or worse than average in the following months or year? I looked at what happened over the following 4, 13, 26, and 52 weeks. Since the most recent one was the second longest that ended in January 2008, we have full data for all instances. I compared the performance in the fourteen instances to all such periods over the 50 years, well over 2,500 cases.

The table shows that once the long run of weeks without a correction ends, the S&P tends not to do as well as its typical performance. This is particularly so for the four weeks following the correction. Only five of the fourteen cases saw the index higher at that point, and both the average and median were a drop of over two percent. For all four of the intervals, the percentage rising was lower after the long up runs than after a randomly chosen week over the last fifty years. In general, the gains for the 13 week and longer periods were lower in the fourteen cases. However, fourteen cases are not nearly enough to have statistical significance. Nonetheless, after a long period without much of a decline in stock prices, it is not surprising that they would take a breather

S&P 500 OVER NEXT 4, 13, 26, 52 WEEKS AFTER LONG UP RUNS, ALL WEEKS

	Next 4 weeks		Next 13 weeks		Next 26 weeks		Next 52 weeks	
	Long Runs	All	Long Runs	All	Long Runs	All	Long Runs	All
Average	-2.05%	0.55%	1.99%	1.81%	3.50%	3.70%	5.12%	7.45%
Median	-2.57%	0.89%	0.30%	2.14%	3.47%	4.32%	11.36%	9.09%
% higher	35.7%	59.1%	50.0%	63.5%	64.3%	66.9%	64.3%	71.1%

or worse over the coming months. This is particularly a risk in a secular bear market, like the one we have been in since 2000. The four worst 52 week results were during secular bears. The worst, a plunge of over 36% followed the January 2008 instance. After June 1969 (141 weeks before a correction), the S&P fell over 20% in the following year, and losses of almost 16% and over 5.5% were seen in 52 weeks following the corrections in April 1973 and August 1981, both after 76 week runs without a 10% drop, respectively.

The trend following models that I use to manage account holdings of funds that track the S&P 500, the Nasdaq 100, and real-estate funds are designed to have us out of those asset types before they have fallen very much. If we get another plunge like that seen in 2007-09, we will sidestep most of the damage as we did then. Although it won't cause me to make any moves not indicated by the models, the end of the current long run without a correction will raise a warning flag that weaker than average stock prices may be on the horizon.