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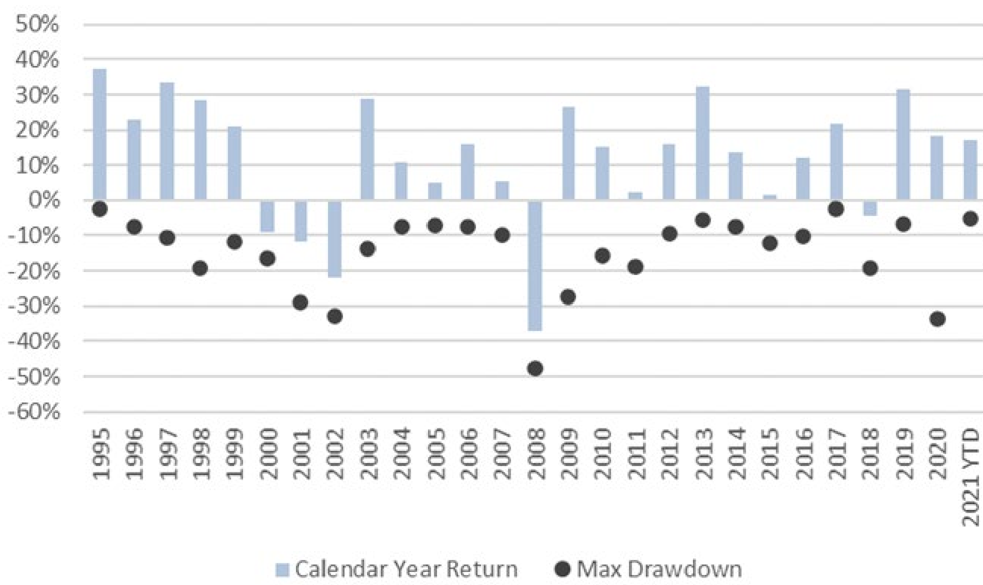
WEEKLY MARKET UPDATE
October 11, 2021

MARKET COMMENTARY

Fig. 1: Calendar year performance and maximum drawdowns for the S&P 500



Sources: Morningstar, Bloomberg, Mill Creek

Certain equity strategists have been in the news recently for forecasting a 10% equity market correction. In response, they've received a lot of blowback from high-profile social media accounts that essentially say "Nothing to see here, a 10% correction happens every year." Who's right? Would a 10% correction be worth talking about, or business as usual?

Part of the disagreement comes from how we define and count a 10% correction. If the market corrects 10%, recovers most of those losses, and then corrects again to the previous level, does it count as one or two corrections? Should the 50% decline experienced during the financial crisis count as five 10% corrections, one large bear market, or something in between? The framing of the question itself leaves a lot to be desired.

Here's what we know:

1. It overstates the case to say that (new) 10% declines occur every year, but it is fair to say that pullbacks of 5-15% occur nearly every year (Fig. 1),
2. At any given time, the historical probability of the market declining by 10% over the next year is about 25-30%,
3. 10% corrections are less likely during periods of strong market momentum like we are in today. The historical frequency of a 10% correction over the next year when the market is trading above its 200-day moving average is only one in ten.

However, we shouldn’t be complacent about equity market volatility. Warren Buffett’s partner Charlie Munger gets it right when he says that 40-50% pullbacks are the “price of admission” to the equity market. If we’re emotionally prepared for those events, *normal* corrections of 5-15% won’t seem all that momentous.

QUICK LINKS

- House View Summary
- Q3'21 Macroeconomic Outlook
- Q3'21 Equity Outlook
- Q3'21 Fixed Income Outlook
- Q3'21 Private Equity Outlook

This week’s contributor: Michael Crook, CAIA