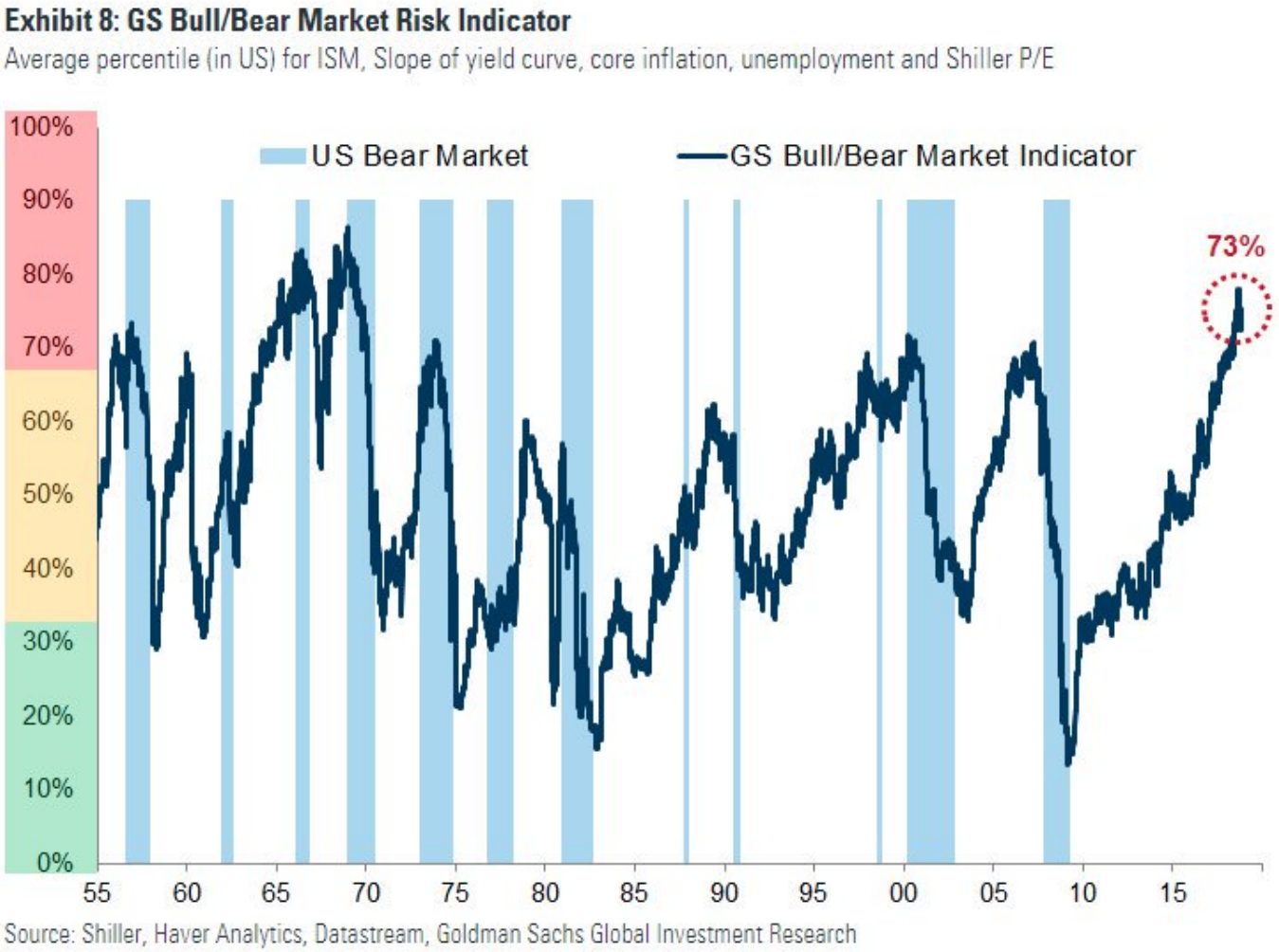
Twitter Thread by Robin Wigglesworth

Robin Wigglesworth
@RobinWigg

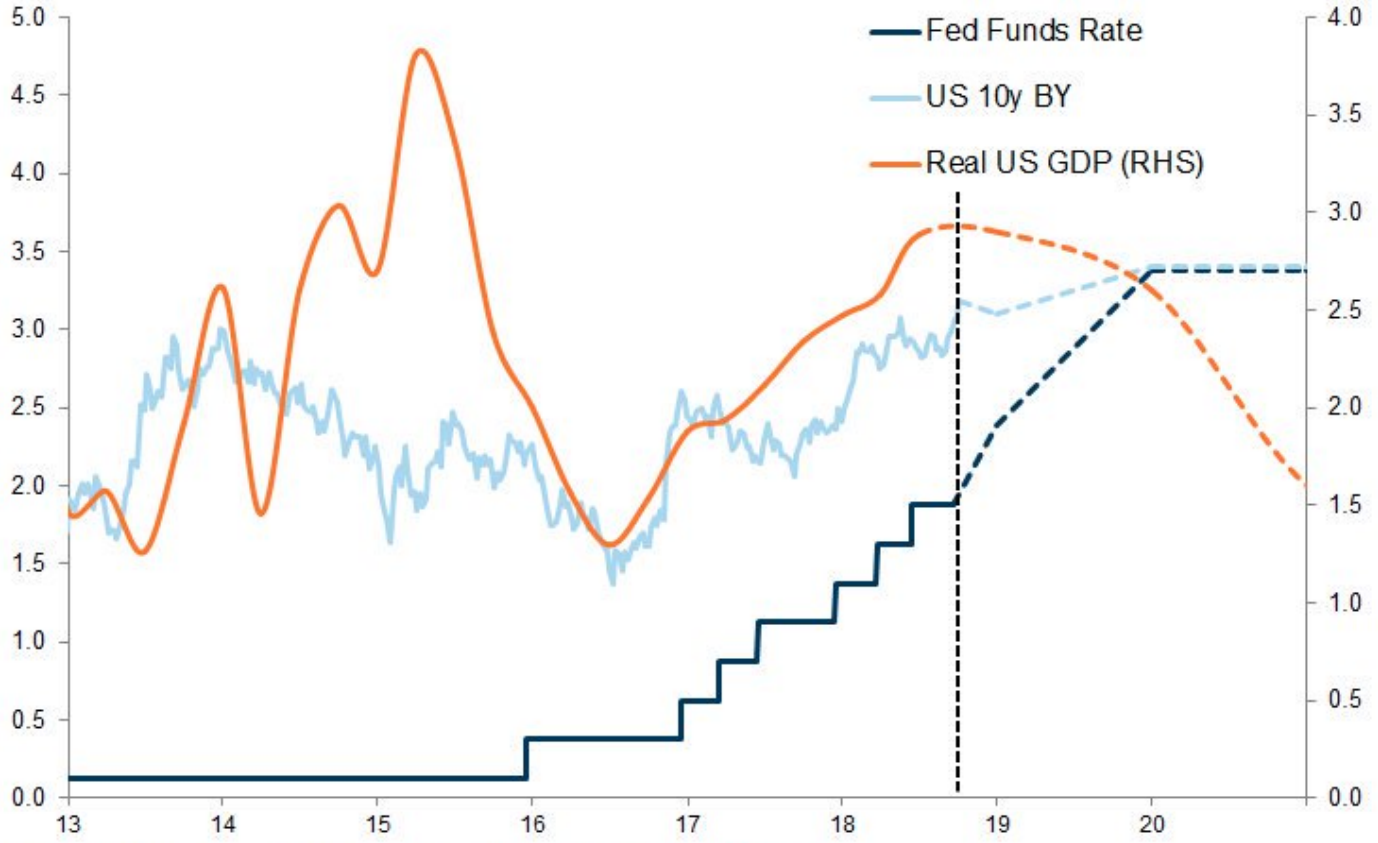
A thread on an interesting report by Goldman Sachs' Peter Oppenheimer, the bank's chief global equity strategist. He points out that Goldman's "Bear Market Risk Indicator" is looking ominous.



There are three factors that suggest that the recent stability could evaporate and that equities are "about to enter a sustained bear market", Oppenheimer says.

First is the fact that growth, inflation and interest rate outlook is unfriendly for equities.

Exhibit 1: Strong growth, but poised to slow, meets rising yields and inflation

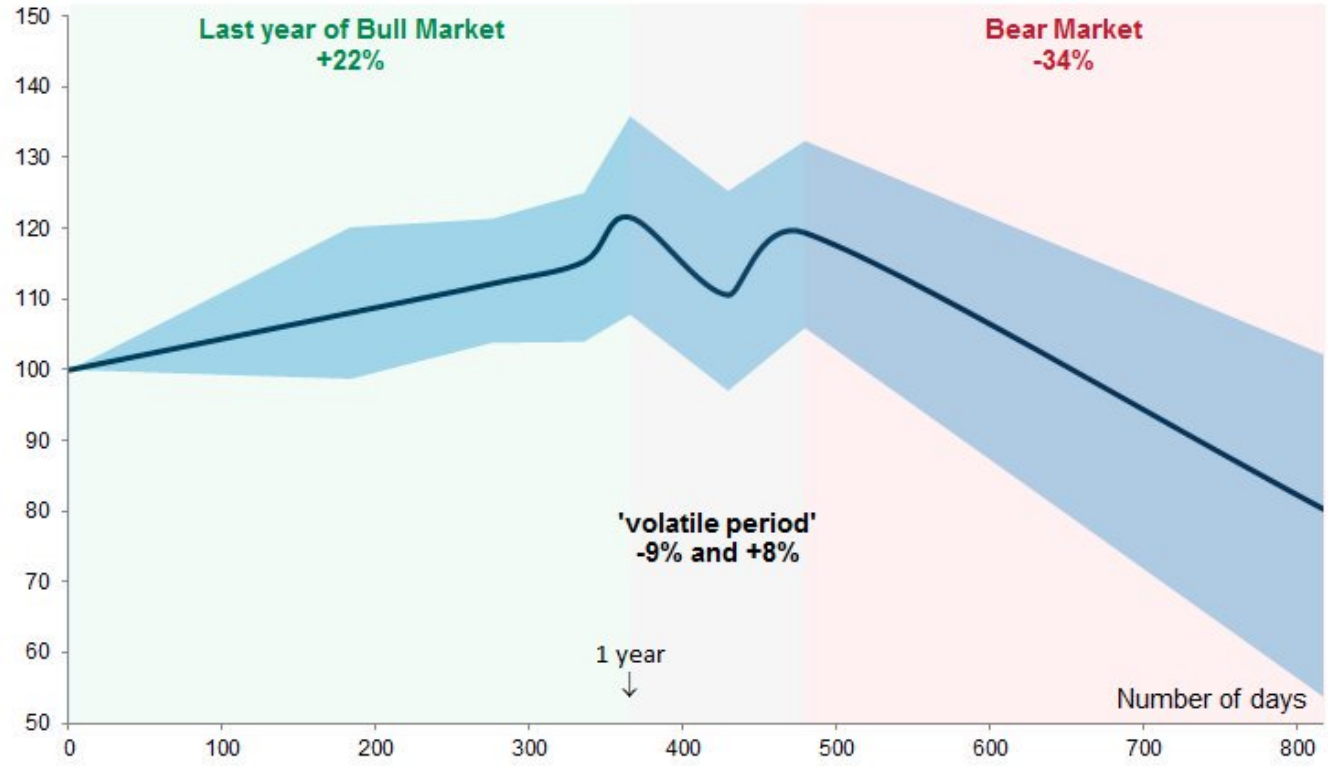


Source: Datastream, Haver Analytics, Goldman Sachs Global Investment Research

Second is that greater volatility, such as multiple corrections and new peaks (which we've seen in 2018) tend to presage a full bear market.

Exhibit 4: The 'typical' profile of the 'Bear Market Bounce'

Average returns and average length of US bear market (ex 1998); data start one year before the peak



Source: Bloomberg, Goldman Sachs Global Investment Research

Here is Goldman's data showing how falls and bounces tend to come ahead of "the dramatic final fall".

Exhibit 5: US bear markets tend to start with a fall, then bounce within a few months, before the dramatic final fall

Start	1st Drop		Bounce		Subsequent drop	
1st peak	# Months from 1st peak	% down from 1st peak	# Months from 1st peak	% up from bottom	# Months from 1st peak	% down from 1st peak
Dec-61	1.6	-7%	3.0	5%	6.4	-28%
Feb-66	1.1	-7%	2.3	6%	7.9	-22%
Nov-68	3.5	-10%	5.4	8%	17.8	-36%
Jan-73	7.3	-16%	9.0	11%	20.7	-48%
Sep-76	1.6	-8%	3.3	9%	17.4	-19%
Nov-80	2.8	-10%	3.8	8%	20.4	-27%
Aug-87*	0.9	-8%	1.3	6%	3.3	-34%
Jun-90*	0.7	-4%	1.4	5%	4.2	-20%
Jul-98**	-	-	-	-	-	-
Mar-00	0.7	-11%	5.3	12%	30.5	-49%
Jul-07*	0.9	-9%	2.7	11%	19.6	-56%
Median	**1.3**	**-9%**	**3.2**	**8%**	**17.6**	**-31%**
Average	**2.1**	**-9%**	**3.8**	**8%**	**14.8**	**-34%**

* This first peak is not our official 'start date' for the bear market

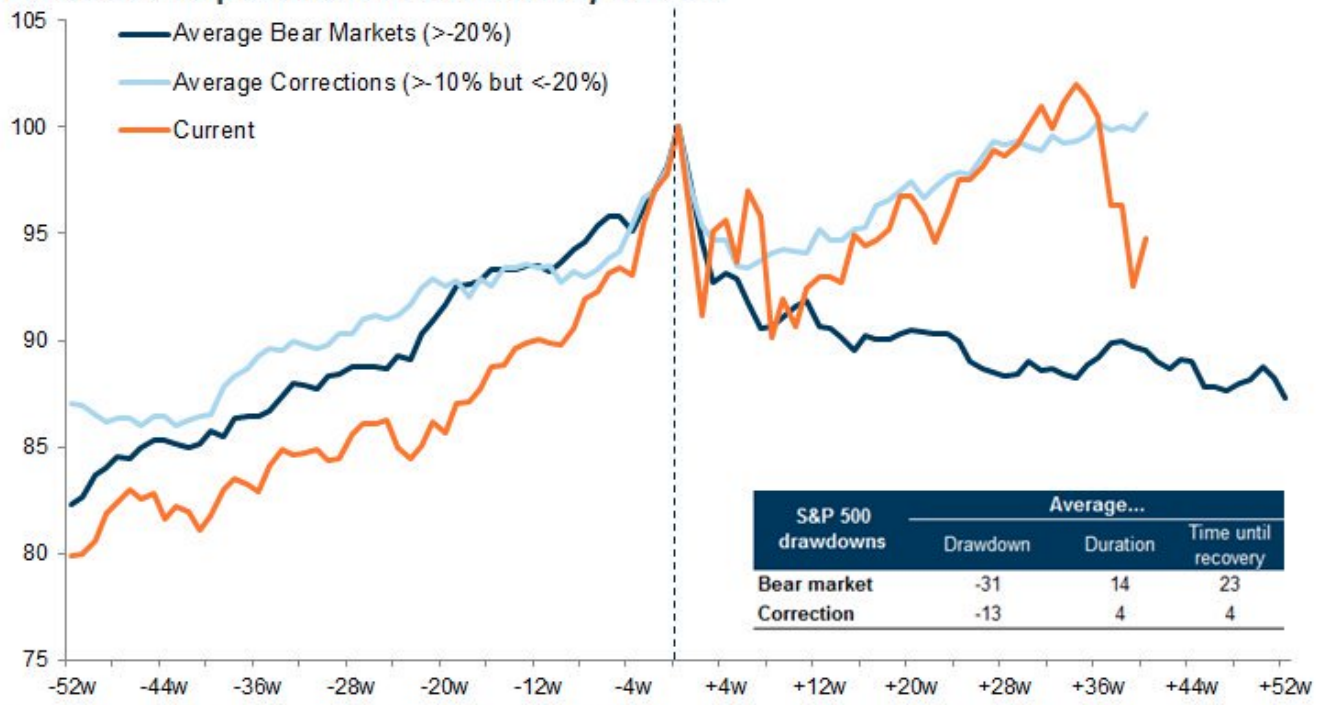
** There was no bear market bounce during the 1998 bear market

Source: Bloomberg, Goldman Sachs Global Investment Research

Oppenheimer: "The risk, therefore, is that from these levels the market enjoys a short-term rally but this becomes a signal to sell rather than buy the market."

The risk, therefore, is that from these levels the market enjoys a short-term rally but this becomes a signal to sell rather than buy the market.

Exhibit 6: A sharp decline is often followed by a bounce



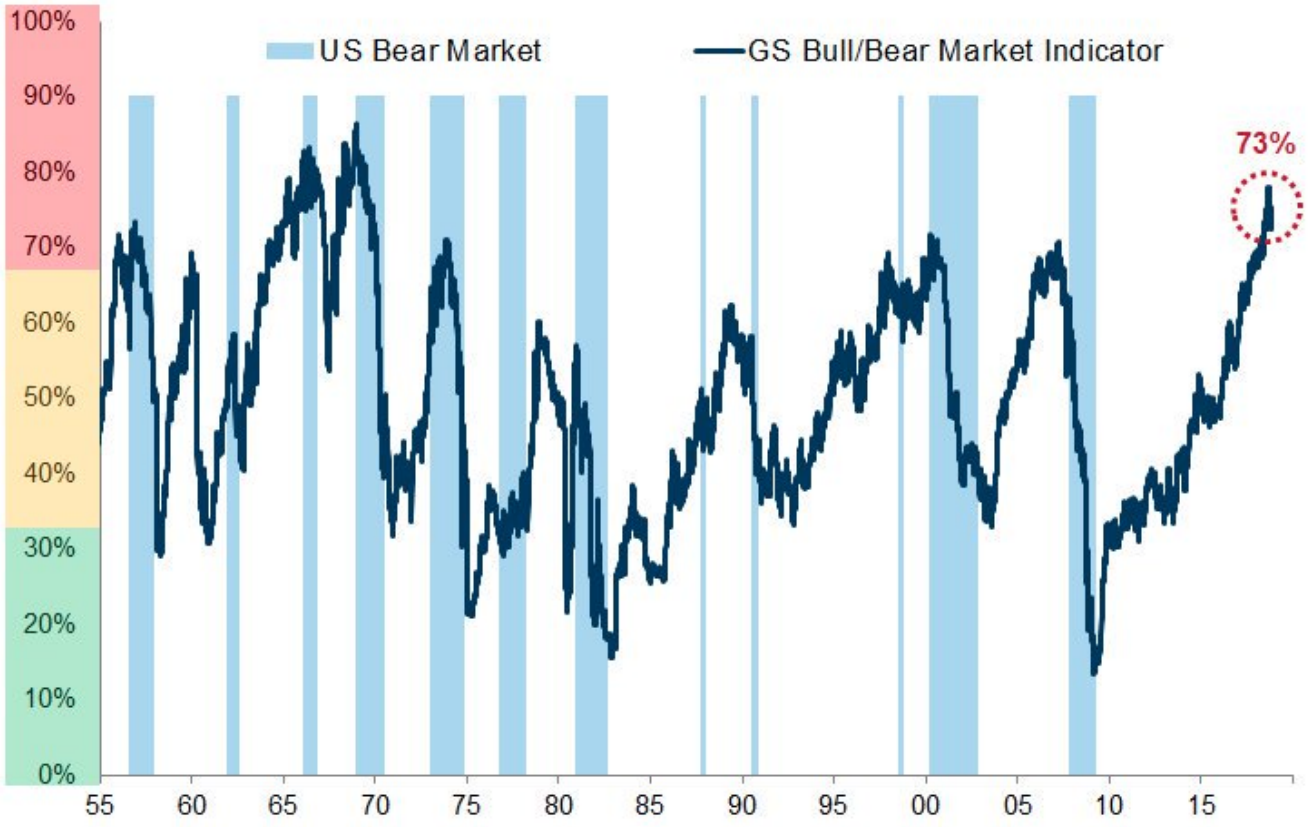
S&P 500 drawdowns	Average...		
	Drawdown	Duration	Time until recovery
Bear market	-31	14	23
Correction	-13	4	4

Source: Bloomberg, Goldman Sachs Global Investment Research

Oppenheimer's third reason to worry is Goldman's own bear market risk indicator (made from a mix of jobs data, inflation, yield curve and valuations). When it rises above 60% it has historically been a good time to turn cautious, and its currently at 73%.

Exhibit 8: GS Bull/Bear Market Risk Indicator

Average percentile (in US) for ISM, Slope of yield curve, core inflation, unemployment and Shiller P/E

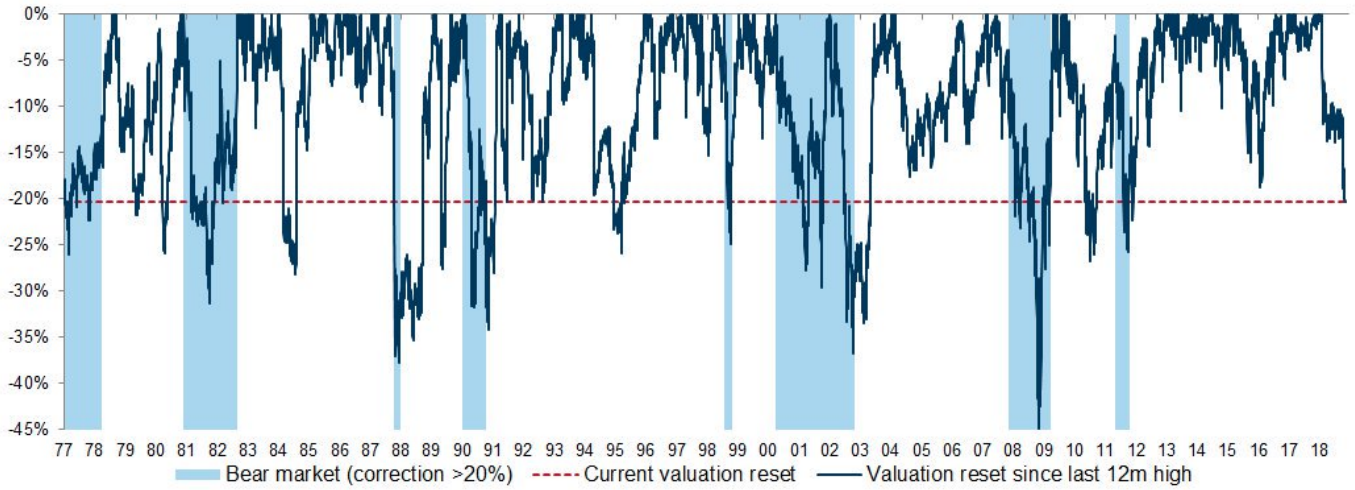


Source: Shiller, Haver Analytics, Datastream, Goldman Sachs Global Investment Research

However, on balance Goldman's Oppenheimer says a prolonged period of more subdued returns is more likely than an outright crash, mostly because valuations are now actually pretty modest after October's slump.

Exhibit 11: Valuation de-rating in equities is one of the largest outside of a bear market

MSCI World NTM P/E change since last 12-month peak in valuation



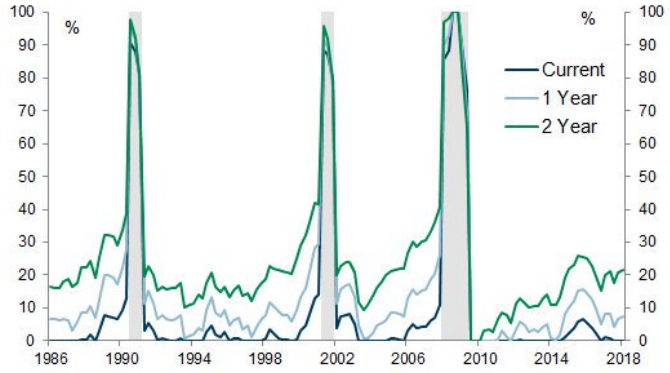
Note: NTM P/E based on S&P 500 data before 1988

Source: I/B/E/S, Datastream, Goldman Sachs Global Investment Research

Goldman also reckons growth will slow but stay positive, points out the multi-decade trend towards less economic volatility. and doesn't see any major financial imbalances.

Exhibit 14 : Recession probability rises from low levels

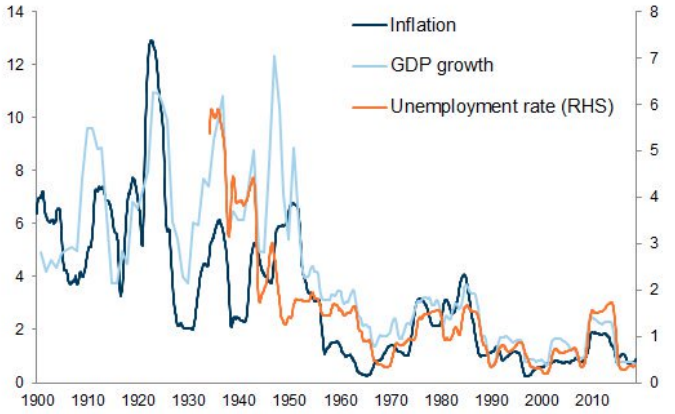
United States Recession Risk



Source: Haver Analytics, Bloomberg, Goldman Sachs Global Investment Research

Exhibit 15 : Volatility of US GDP growth, inflation and unemployment rates has declined, especially since the 1980s

5-year rolling volatility



Source: GFD, Jorda-Schularick-Taylor Macrohistory Database, Goldman Sachs Global Investment Research

Against that, Goldman can see three causes for concern. 1. A lack of fiscal and monetary policy flexibility in the US, with budget deficit ballooning and interest rates still low compared to history.

1. Lack of policy flexibility

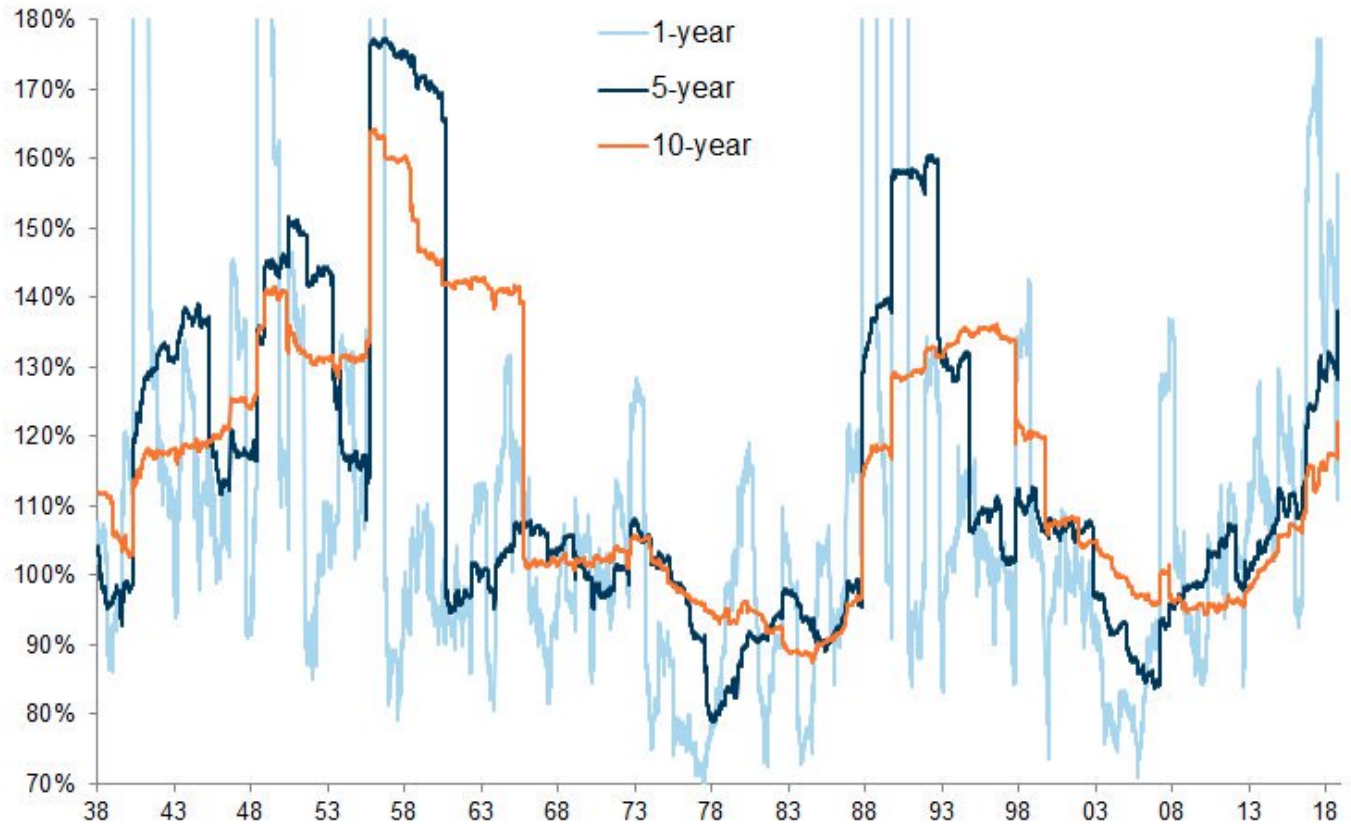
- The **US has already expanded fiscal policy,** and its debt levels and budget deficit are rising, which could make it difficult to find room for significant easing.
- Meanwhile, **the Euro area is in a much better position fiscally**. According to IMF estimates, the Euro area budget will be in balance by 2022. Arguably, the Euro area countries would be able to stimulate their economies with a fiscal boost – **but this would depend a great deal on the political mood in Germany**, since it accounts for the bulk of the likely surplus.
- **There may be room for US interest rates to be cut in the next downturn but less so than in other downturns.** Also, European interest rates may still be at or close to zero when the next US downturn hits. The same would be true for Japan.

It's notable that, as rates have fallen – and in the case of the Euro area and Japan moved into negative territory – this has not pushed up equity valuations. Partly this is because negative rates have an adverse effect on Financials. It is also partly because low rates are a symptom of economic weakness, although we think the lack of policy room also has an impact – in Europe and Japan the gap between the dividend yield and 3-month interest remains wide, whereas it has fallen in the US (as rates have started to rise). So, even if we get a slowdown and no recession, the prospects of a coordinated and strong policy boost globally is likely to be limited, suggesting any slowdown becomes more entrenched.

Secondly, (and a subject dear to my heart), the seismic shift towards more machine-driven markets, which seems to have lifted the volatility of market volatility, even as economic volatility has drooped lower.

Exhibit 19: Vol of vol has trended up since the GFC

Volatility of S&P 500 1-month volatility (daily)



Thirdly, Oppenheimer highlights concentrated flows, ETF explosion, positioning and crowding, which could lead to more exaggerated market moves in a downturn.

Exhibit 20 : The record outperformance of 'Growth' vs. 'Value'

MSCI World Value vs. Growth



Source: Datastream, Goldman Sachs Global Investment Research

Exhibit 21 : High-growth stocks trade on their highest premium to low-growth stocks since 2000

MSCI AC World: Based on FY3 consensus sales growth: High sales growth >8%, low sales growth <4%



Orange = 12m moving average

Source: Datastream, I/B/E/S, Goldman Sachs Global Investment Research

The report ends by examining the anatomy of different types of bear markets, categorizing them into the classic cyclical downturn, event-driven ones triggered by an external shock, and structural ones, driven by financial bubbles and imbalances.

Exhibit 24: Characteristics of a bear market

Pre Bear	Cyclical	Event	Structural
Rising rates	✓	Maybe	✓
Exogenous shock	Maybe	✓	Maybe
'Speculative Rise' in equity prices	×	×	✓
Economic Imbalances	×	×	✓
Rising productivity	Maybe	-	✓
Unusual strength in economy	×	×	✓
' New Era' belief	×	×	✓
Post Peak	**Cyclical**	**Event**	**Structural**
Economic recession/downturn	Usually	Maybe	Usually
Profits collapse	✓	Maybe	✓
Interest rates fall & trigger rise in equity prices/fall in bonds	✓	Usually	×
Price shock	×	×	✓

Source: Goldman Sachs Global Investment Research

Here is a list of every US bear market since the 1800s, categorised according to type, and with how long they lasted and how long the recovery took.

Exhibit 25: US bear markets since the 1800s

S - Structural bear market, E - Event-driven bear market, C - Cyclical bear market

S&P 500 - Bear Market					Time to recover back to previous level	
Type	Start	End	Length (m)	Decline (%)	Nominal (m)	Real (m)
S	May-1835	Mar-1842	82	-56	259	-
C	Aug-1847	Nov-1848	15	-23	42	-
C	Dec-1852	Oct-1857	58	-65	67	-
C	Mar-1858	Jul-1859	16	-23	11	-
C	Oct-1860	Jul-1861	9	-32	15	-
C	Apr-1864	Apr-1865	12	-26	48	-
S	Feb-1873	Jun-1877	52	-47	32	11
C	Jun-1881	Jan-1885	43	-36	191	17
C	May-1887	Aug-1893	75	-31	65	49
C	Sep-1902	Oct-1903	13	-29	17	22
E	Sep-1906	Nov-1907	14	-38	21	250
C	Dec-1909	Dec-1914	60	-29	121	159
C	Nov-1916	Dec-1917	13	-33	85	116
C	Jul-1919	Aug-1921	25	-32	39	14
S	Sep-1929	Jun-1932	33	-85	266	284
S	Feb-1937	Apr-1942	62	-57	48	151
C	May-1946	Feb-1948	21	-25	27	73
E	Aug-1956	Oct-1957	15	-22	11	13
E	Dec-1961	Jun-1962	6	-28	14	18
E	Feb-1966	Oct-1966	8	-22	7	24
C	Nov-1968	May-1970	18	-36	21	270
S	Jan-1973	Oct-1974	21	-48	69	154
C	Sep-1976	Mar-1978	17	-19	17	93
C	Nov-1980	Aug-1982	20	-27	3	8
E	Oct-1987	Dec-1987	2	-32	19	22
C	Jul-1990	Oct-1990	3	-20	4	6
E	Jul-1998	Aug-1998	1	-19	3	4
S	Mar-2000	Oct-2002	30	-49	56	148
S	Oct-2007	Mar-2009	17	-57	49	55
Average			**26**	**-36**	**56**	**85**
Median			**17**	**-32**	**32**	**49**
Average Structural			**42**	**-57**	**111**	**134**
Average Cyclical			**26**	**-30**	**48**	**75**
Average Event Driven			**8**	**-27**	**12**	**55**

FIN.