

Client's Corner

What We Need Now Is a Nice, Normal Bear Market

THE U.S. STOCK MARKET IS ON AN EPIC TEAR. TOTAL returns (with dividends) for the S&P 500 in recent years have been:

2023	26.3%
2024	25.0%
2025	17.9%

As I write, having all but instantly shaken off a nearly 10% correction ignited by the Mideast war, the Index is up eight percent on the year—after only half that year, mind you.

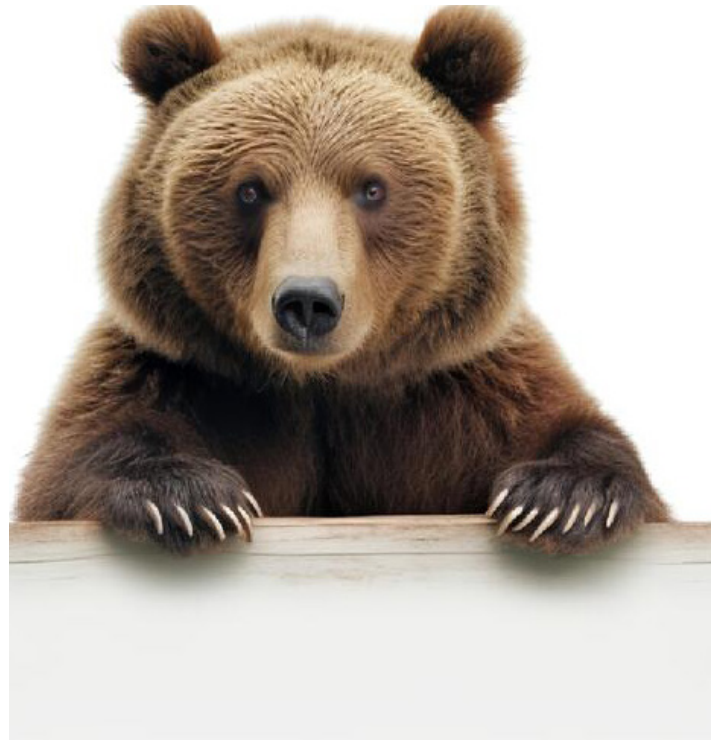
Now, without in any way inferring a causality, do you remember what this extraordinary winning streak grew directly out of? If not, permit me to remind you.

2022	-25.4%
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Yes, from January 3 through October 12, 2022, we had a 25% bear market. And deservedly so. That year saw inflation spike to nine percent. The global supply chain was in shambles. The Fed, awakening to inflation far too late, engineered the fastest, sharpest set of interest rate hikes in its hundred year history. Bond prices cratered; the classic 60% stocks/40% bonds portfolio endured its worst year since (drum roll, please) **1937!**

It was (to employ words written and spoken by financial journalism perhaps thousands of times over those ten long months) a “bloodbath” in which there was “nowhere to hide” and “no end in sight.” Is any of this coming back to you? If so (and even if not) allow me to begin hinting at the major point of this minor essay. To wit: ***This is how it has always worked.***

More on that conclusion in a moment. But first I'd like to zoom in much closer to recent experience—specifically, the period April 2 through June 5 of this year. On April 2, there came to market a brand new ETF concentrated with laser-like focus on semiconductor stocks—the very hottest segment of this red hot stock market. The ETF reached



\$10,000,000,000—that's ten billion dollars—in assets in just 43 trading days, a new record. (The previous record holder? You guessed it: a Bitcoin ETF. You could look it up.)

On Friday, June 5—spooked by whatever it had chosen to get spooked by—the Nasdaq 100, epicenter of the tech mania, fell nearly five percent. That was nothing: the stock markets of Taiwan and South Korea—which are even more hideously overconcentrated in semiconductors than ours is—went down seven percent and 14% respectively. The VIX—Wall Street's semi-official “fear gauge”—spiked by 40%, an extremely rare occurrence. ***All that in just one day.***

What do I conclude from this two-month euphoria/panic episode? I'll try to explain.

We have had, since that last bear market worthy of the

name, a tremendous increase in share values, propelled not just by a major technology breakthrough but by a historic increase in corporate earnings and profit margins. And earnings are what drive stock prices in the long run.

In the next breath, we must observe that after several years of extraordinary performance concentrated in the big-cap tech sector, the stock market has generated rarely seen peaks of investor excitement. (Hence \$10 billion in a new ETF in 43 trading days.) Yet there is clearly a commensurately rising level of very real fear: that all of this is a bubble, that it has to end badly, and that stock prices may be subject to a sickening decline at almost any moment. (Hence a five percent crash in Nasdaq, and a 40% spike in the VIX, in just one day.)

Question: How is the goal-focused, plan-driven, long-term equity investor to deal with this conundrum? In this one man's opinion, by pulling our focus back from the tensions of today, and looking at the very clear pattern of the equity market over time. That record is: a number of years of rising prices, followed by a significant but hitherto always temporary decline, followed by a resumption of the long-term advance to new high levels.

The S&P 500 came into the year 1950 at 17. (This is not a misprint.) It is currently around 7,400. In the interim there have been by my count—and I count from a euphoric intraday peak to a panic-stricken intraday trough—17 episodes in which the Index declined at least 20%. That's an average of about one every 4.5 years. The average decline was upwards of 30%—not much above that of 2022, which no one seems to remember.

The compound annual growth rate (dividends reinvested) of the Index from January 1950 through May of this

year was 11.6%. A \$10,000 investment in the Index in January 1950 (which I hurriedly concede was not feasible at the time) and left to compound had grown to \$44.7 million on May 31 of this year. (This, too, is not a misprint.)

It should be clear to you that the advance in share values (and reinvested dividends) has dwarfed the frequent, sometimes significant, but hitherto always temporary drawdowns, both in strength and in duration. And since neither the onset nor the bottom of a market decline can ever be consistently timed, we long-term investors are committed to riding them out, in quest of the premium returns.

Now, just when you might have despaired that I would ever come to the point of this essay's title, it's simply this:

With the serial explosions of alternating speculative frenzy and stark terror currently going on all around us, perhaps the most rational thing the long-term equity investor might wish for is another 2022: a nice, long, panic-driven cleansing of the speculative excesses. After which—if history is any guide, and it's the only guide we have—the normal advance of mainstream equity values and dividends that has been in effect since 1950 (and far longer) can resume on a firmer footing.

As Clemenza so memorably says to Michael Corleone: “These things gotta happen every five years or so, ten years. *Helps to get rid of the bad blood.*” To long-term investors concerned that a significant correction must be coming at some point, one can only say, “Yes, and the sooner the better.”

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Sources: New ETF data: Morningstar. June 5 declines: *The Wall Street Journal*. S&P 500 declines since 1950: Standard & Poor's, Yahoo Finance. CAGR since 1950: Standard & Poor's, S&P 500 return calculator on the website “Of Dollars and Data.”