What Are Market Cycles?

Understanding the highs and lows of the stock market can sometimes feel like trying to predict the weather. One minute it's sunny, the next heavy rain is falling. One day you need a winter jacket, the next it's flip-flop season. While these weather changes might seem random, if you look closely enough, you'll begin to see the patterns. Even as the lazy hazy days of summer come to an end, you know they'll be back again someday…

The stock market also has patterns, which are often called cycles. The natural cycle of markets is to rise and fall. The falls can be scary — for example, during the 2008 global financial crisis or the COVID-19 pandemic — but the stock market has historically continued to cycle and rise again. These cycles can last for days or even years but once you understand the patterns it's easier to focus on the longer term.

Want to know more about market cycles? Let's dive in.

Why do markets "cycle"?

As time goes by, there are more and more people in the world. And with technological improvements, companies and their employees can become more productive and produce more products and services. If the demand for a product or service increases, its value increases — and so does the overall value of the company that produces it. That's what stock prices are — a reflection of the value of the companies they represent.

While historically stock prices have been shown to rise overall in the long-term, that doesn't mean there won't be dips in the market along the way. Reasons that stock prices may fall include changes in access to labour, interest rate changes, geopolitical disruptions, changes in consumer purchasing habits and global shortages of key commodities. Even things like investor expectations or perceptions can affect stock prices. Investors can also misjudge the value of companies and how profitable they'll be in the future. You may have heard the phrase "stock market bubble" — this is when investors rush to buy stocks and bid up prices beyond what the companies are worth. When this bubble bursts, stock prices fall.

It is important to remember that falling markets are an opportunity — by buying into the market when stock prices are down, investors are able to take greater advantage of the eventual market recovery.

What is a bull market?

A bull market refers to a period when stock prices consistently rise — as they did in the U.S stock market from 2009 - 2020. The economy had recovered from the 2008 bear market and though individual stock prices fell in value during this time, overall, it was the longest modern era bull market.

Many people use the term "bull market" as a general reference to strong and rising markets. The most common definition is when stock prices rise over 20% during a specific period without

dropping an equal amount. In other words, even if the market fell 19% during a given period, if prices rebounded and kept rising it wouldn't end the bull market.

During this "bullish" period in the market cycle, investors can get very optimistic and confident, leading to what's called "irrational exuberance." This can lead people to leave their carefully planned, long-term strategies and to take on more investment risk by buying stocks when markets are peaking — a risky move.

What is a bear market?

The opposite of a bull market is a bear market. When most people think of bear markets, they think of stock prices continue to fall. In fact, a bear market is defined as a scenario in which stocks fall 20% or more without rising an equal amount during a given period.

Market declines of about 10% are generally not categorized as a bear market. These are called "corrections" and they generally happen as a result of an overreaction to a specific event. This is a common cause of panic as it creates shorter-term bouts of market volatility that can lead investors to take their eyes off the prize.

Falling prices can lead to stress and worry — sometimes, people make investment decisions based on emotions instead of facts. Investors may sell otherwise "quality" stocks at low prices. For example, a company with a good business model and smart management may see its stock price fall because the market did, not because anything changed at the company. Investors might be tempted to sell these stocks instead of holding out for the long term.

It is important to note that a bear market isn't the same thing as what's called a stock market crash. A stock market crash is used to describe headline-grabbing, dramatic plunges in the market that happen in a day or two. Bear markets are a longer, drawn-out fall in prices.

How long do market cycles last?

There's no simple answer. A full market cycle is usually defined as the period between two highs. In other words, a bull market, then bear market, then another bull market.

The exact timing of these cycles changing can't be predicted, which is challenging. However, it's counterproductive to focus on this question. Timing the market is often a zero-sum game. Historical data shows there's a great likelihood of making a higher long-term return by staying invested and riding out market ups and downs.

A well-planned, long-term strategy can help you stay focused on your investing goals. Talk to an Edmond Financial Group advisor today about developing a comprehensive financial planning strategy suited to your unique needs.