MUTUAL FUND UPS AND DOWNS: A LOOK AT THE BEAR FACTS

By John Markese

Knowing how a mutual fund is likely to perform in both up and down markets will allow you to make more appropriate fund selections. However, funds that are likely to soar in bull markets are also likely to plummet in bear markets.

One thing we know with certainty about investing: There will be bull and bear markets, and mutual funds will be pulled along in their wakes.

It is equally important to know how a mutual fund performs both during a bull market and during the inevitable bear market to follow. If, for example, you make 100% and then lose 50% on your mutual fund investment, you're back to square one. So, knowing how a mutual fund is likely to perform in both up and down markets will allow you to make more appropriate fund selections and to build a more rational portfolio.

First, let's dispel one dream. Funds that are likely to soar in bull markets are also likely to plummet in bear markets. There are simply no funds that rocket up with the market blast-off and then hold their ground when all funds around them are plunging. While market-timing funds have touted an objective of being "up in up markets and in cash before the crash," few have ever remotely lived up to that promise for very long.

Second, funds that dangle before investors the concept of being up in down markets—bear funds—usually are slaughtered in bull markets.

Third, the terms "bull" and "bear" markets are tossed around by financial pundits, and although investors nod their heads understandingly when reading and hearing these pronouncements, few on either side have any handle of just what constitutes a bull or bear market. So, let the statistics speak to a definition.

Over the last three-quarters of a century, the average bull market has provided about a 100% total return, while the average bear market has produced a loss of around 25%. And the bull market/bear market count is about even since the mid-1920s: 24 bull markets and 23 bear markets. These figures refer, of course, to domestic stocks. Bonds have had their own bull and bear markets, as have international stocks.

The biggest bull?

The 10-year period after World War II produced an astounding return of nearly 500%.

The worst bear?

No, not the 1929 crash, but a few years in the early 1930s, when the market fell almost 80%.

Bull markets, on average, last around 28 months, while the average bear market lasts nine months. If the definition of a bear market is down 10% or more and anything less is a blip in a bull market, then bull markets will tend to outrun bear markets. But the lessons of history should be clear: Bear markets are abrupt and ensuing bull market gains overshadow bear market losses, eventually. However, "eventually" can take some time—the losses of the late 1920s and 1930s were not totally covered until the end of World War II, although there were plenty of bull and bear markets in the intervening years.

Recent market experiences may help investors develop an intuitive feel for how funds behave during both bull and bear markets. Table 1 shows how all the fund categories behaved, including fixed-income and international, during a stock bull market period—July 1, 1994, through April 30, 1998—and a stock bear period—May 1, 1998, through August 31, 1998.

John Markese is president of AAII.

TABLE 1. FUND CATEGORY AVERAGES: BULL AND BEAR MARKET PERFORMANCE

	Return (%)		Overall Period (7/1/97 to 8/31/98)			
Category	Bull Mkt (7/1/94 to 4/30/98)	Bear Mkt (5/1/98 to 8/31/98)	Total Return (%)	Largest Monthly Gain (%)	Largest Monthly Loss (%)	Standard Deviation (%)
Aggr Grth	142.6	–25.2	81.4	10.7	–19.2	17.1
Growth	137.6	–19.0	92.3	7.3	–16.3	13.5
Grth & Inc	126.9	–15.1	92.5	6.3	–12.9	11.3
Balanced	88.0	–9.2	70.6	5.2	–8.6	8.0
Corp Bond	37.8	1.4	39.8	3.2	–1.1	3.1
Hi-Yield Bond	66.0	–5.4	57.0	2.8	–6.2	4.9
Gov't Bond	38.4	5.6	46.1	4.8	–2.6	5.0
Mort-Bk Bond	33.6	3.3	38.0	2.9	–1.1	2.9
Gen'l Bond	33.6	2.9	37.5	3.2	–1.5	3.1
Tax-Ex Bond	28.7	3.6	33.4	2.7	–1.8	3.7
Int'l Stock	41.5	–20.9	11.9	7.6	–16.9	14.5
Int'l Bond	41.4	–7.4	30.8	3.3	–6.6	5.4
Gold	–29.0	–45.3	–61.2	19.4	–23.3	30.9

Source: AAII's Quarterly Low-Load Mutual Fund Update

The aggressive growth, growth, and growth and income categories performed in the bull market as would be expected: Aggressive growth, with the highest risk, had the highest return; it was followed by the growth category, and then growth and income.

Higher returns come with higher risk, and the greatest monthly gains and greatest monthly losses are larger for aggressive growth funds on average than for growth and growth and income. And it should be emphasized that these are *monthly* losses—for example, the largest one-month loss for aggressive growth funds on average was a drop of 19.2%. Individual funds certainly managed to do much worse.

Standard deviation is another risk measure. The larger the standard deviation, the greater the variation in monthly returns over this entire period. For instance, the standard deviation of aggressive growth funds (funds that invest in riskier growth stocks) is 17.1%, which is more than twice the volatility of the average balanced fund, made up of less volatile stocks along with bonds.

Bond funds show less explosive returns in the bull market period, but produce positive returns in the bear market period. Corporate high-yield bond funds, also referred to as junk bond funds, double the returns of many of the other bond fund categories, but at a cost. The average high-yield bond fund lost 5.4% during the bear market.

International stock and bond funds both produced bond-like returns during the bull market and stock-like returns during the bear market. Gold jumped from merely terrible in the bull market—down 29.0%—to horrible in the bear market—down 45.3%; the compound return for the total period for the average gold fund was –61.2%. (Note that, mathematically, you cannot simply add the period returns together to determine the compound return for the total period.)

Unless you are a timer extraordinaire, the total return figures covering both the bull and the bear market should be your focal point. For instance, while the average aggressive growth fund pulls away from the other categories during bull markets, they gave back more during the bear markets; meanwhile, the growth and growth and income categories were in almost a dead heat for the entire period, with both besting aggressive growth for total return honors.

Table 2 lists the top 20 non-sector stock funds ranked by performance in the bull market period, as reported in AAII's *Quarterly Low-Load Mutual Fund Update*. Sector funds are funds that concentrate in one or more related industries; they are not diversified. They are excluded because sector funds would dominate a top-performers list as well as a worst-performers list simply because of their lack of diversification.

The Rydex: OTC fund is in first place, with a 253.8% return for the bull market, while being down only 7.9% during the bear market. This fund also topped the total return column with 225.8%. Other funds were high in the bull performance column—SAFECO Growth at 207.0%, for example—but gave back substantial returns during the bear market period—a loss of 31.5% for SAFECO Growth. SAFECO Growth's total return for the entire period was 110.3%.

The largest one-month losses for this group of top-performing bull market funds ranged from a loss of 24.2% (the worst) to a loss of 12.0% (the best); all gave one-month punches to their investors.

The standard deviations of these funds, in comparison to the category average, confirm the rule: Funds that perform the best in bull markets have substantially greater risk on average, and that applies both absolutely compared to all funds, and relatively compared to other funds in their categories.

Table 3 lists the top 20 diversified domestic stock funds ranked by bear market performance. At the top of the list, with a 17.9% return, is the Rydex: URSA fund, a growth and income fund. During the same bear market period, the average growth

TABLE 2. TOP-PERFORMING STOCK FUNDS DURING BULL MARKET

		Return (%)		Overall Period (7/1/97 to 8/31/98)			
Category	Fund (Ticker)	Bull Mkt (7/1/94 to 4/30/98)	Bear Mkt (5/1/98 to 8/31/98)	Total Return (%)	Largest Monthly Gain (%)	Largest Monthly Loss (%)	Standard Deviation (%)
Aggr Grth	Rydex: OTC/Inv (RYOCX)	253.8	–7.9	225.8	16.2	–16.9	22.2
Aggr Grth	White Oak: Growth (WOGSX)	245.3	–21.6	170.4	15.6	–23.5	21.8
Aggr Grth	Rydex: Nova/Inv (RYNVX)	244.6	–22.0	168.8	11.7	–21.5	20.3
Aggr Grth	Turner: Small Cap Grth (TSCEX)	242.8	–31.4	134.9	15.4	–24.2	24.5
Growth	Weitz Srs: Hickory (WEHIX)	237.6	–9.5	205.4	14.3	–12.0	16.5
Growth	Legg Mason Eq: Value/P (LMVTX)	237.5	–15.3	185.9	13.4	–19.1	17.1
Growth	Torray Fund (TORYX)	214.9	–24.0	139.0	8.8	–18.1	15.3
Aggr Grth	SAFECO Growth (SAFGX)	207.0	–31.5	110.3	15.1	–24.2	20.2
Growth	Fidelity Dividend Growth (FDGFX)	203.4	–11.1	169.5	8.4	–13.1	13.6
Growth	Sequoia Fund (SEQUX)	203.0	–11.9	166.9	10.1	–13.7	16.0
Growth	SteinRoe Young Investor (SRYIX)	199.8	–19.5	141.2	8.4	–18.5	16.2
Growth	Vanguard Index: Growth (VIGRX)	194.1	–8.7	168.4	8.0	–13.0	14.1
Aggr Grth	Janus Twenty (JAVLX)	192.8	–3.5	182.3	11.8	–15.1	16.7
Aggr Grth	Fidelity New Millennium (FMILX)	192.6	–24.6	120.5	13.4	–21.7	20.3
Growth	Rainier: Core Equity (RIMEX)	191.5	–21.1	129.8	7.7	–17.6	14.8
Grth & Inc	Reynolds: Blue Chip Growth (RBCGX)	190.5	–10.2	160.7	10.6	–15.0	16.4
Growth	Northeast Inv Growth (NTHFX)	189.3	–15.7	143.6	8.8	–16.8	15.6
Growth	Harbor: Capital Apprec (HACAX)	188.3	–16.6	140.4	12.7	–19.0	18.2
Aggr Grth	Rainier: Small/Mid Cap Eq (RIMSX)	187.9	–29.2	103.8	8.2	–20.4	16.5
Growth	Papp America: Abroad (PAAFX)	187.0	–17.9	135.4	10.2	–14.7	14.7

Source: AAII's Quarterly Low-Load Mutual Fund Update

TABLE 3. TOP-PERFORMING STOCK FUNDS DURING BEAR MARKET

		Return (%)		Overall Period (7/1/97 to 8/31/98)			
Category	Fund (Ticker)	Bull Mkt (7/1/94 to 4/30/98)	Bear Mkt (5/1/98 to 8/31/98)	Total Return (%)	Largest Monthly Gain (%)	Largest Monthly Loss (%)	Standard Deviation (%)
Grth & Inc	Rydex: URSA (RYURX)	–51.7	17.9	–43.0	16.8	–6.9	13.8
Aggr Grth	Caldwell & Orkin Mrkt Opp (COAGX)	99.4	15.3	130.0	9.0	–2.0	7.4
Grth & Inc	Rightime Fund (RTFDX)	53.0	–2.1	49.8	7.2	–5.1	8.5
Growth	Flex–fund: Muirfield (FLMFX)	69.8	–2.6	65.4	7.5	–6.5	10.4
Growth	Mathers Fund (MATRX)	8.2	–2.6	5.4	3.4	–3.8	5.2
Grth & Inc	Gateway Fund (GATEX)	54.9	–3.1	50.0	3.3	–5.0	4.8
Growth	Merger Fund (MERFX)	48.4	–3.4	43.3	2.4	–5.2	4.0
Aggr Grth	Janus Twenty (JAVLX)	192.8	–3.5	182.3	11.8	–15.1	16.7
Aggr Grth	Lindner Bulwark/Inv (LDNBX)	–3.4	–4.6	–7.9	14.6	–11.1	16.5
Grth & Inc	Copley Fund (COPLX)	78.0	–5.7	67.8	7.6	–3.9	9.2
Growth	Clipper Fund (CFIMX)	145.9	–5.8	131.5	6.8	–7.6	10.9
Growth	Weitz Srs: Value (WVALX)	163.9	–6.2	147.5	9.8	–9.8	12.1
Growth	T. Rowe Price Cap Apprec (PRWCX)	84.6	–7.2	71.2	4.5	–4.6	6.3
Aggr Grth	Rydex: OTC/Inv (RYOCX)	253.8	–7.9	225.8	16.2	–16.9	22.2
Growth	Weitz Partners Value Fund (WPVLX)	173.6	–8.2	151.0	10.0	–11.3	12.6
Growth	Vanguard Index: Growth (VIGRX)	194.1	–8.7	168.4	8.0	–13.0	14.1
Growth	MSB Fund (MSBFX)	122.0	–8.9	102.1	7.9	–10.7	12.0
Grth & Inc	Strong Total Return (STRFX)	107.6	–9.2	88.5	8.9	–13.6	13.6
Growth	Weitz Srs: Hickory (WEHIX)	237.6	–9.5	205.4	14.3	–12.0	16.5
Grth & Inc	Philadelphia Fund (PHILX)	111.5	–9.5	91.3	7.3	–11.0	11.8

Source: AAII's Quarterly Low-Load Mutual Fund Update

and income fund lost 15.1%. But for those familiar with Latin, you would have guessed that sort of performance—*ursa* translates to bear. For this fund, the largest monthly gain was significant, at 16.8%, while the largest monthly loss was relatively small, at –6.9%; its standard deviation is a reasonable 13.8%. However, the fund's total return for the period is –43.0%. Why? The fund lost 51.7% during the bull market period.

Among the other top-performing bear market funds, almost all had small losses in the bear market but many still managed big gains during the bull market, so that their total return for the overall period outperformed their category averages. On the other hand, half of these bear funds failed to make enough gains during the bull market to keep pace with their category averages for the overall period. Four funds, however, managed to make it to both the Table 2

and Table 3 lists.

Some of the “both-ways” performance (good in both bull and bear markets) is due to industry weightings—including technology and, more specifically, Internet holdings—that held up well during the overall market. But picking the funds that will pick the right sectors for bull and bear markets is a daunting—and risky—task for investors.

A list of the worst-performing funds in a bull market would have many bear market stars. And a list of the worst-performing funds in a bear market would have bull market stars. It is simply tough to have it both ways, and the funds that did were few and only obvious in retrospect.

Here are some general points to remember when sorting out bull/bear performance.

- Bull markets last longer than bear markets.
- Bull markets produce returns much greater than bear market losses.
- Funds that produce stellar bull market performances rarely perform well in bear markets.
- Funds that do well in bear markets usually fail to produce memorable returns in bull markets.
- Bull markets count more than bear markets for long-term investors.
- Finding well-diversified stock funds that have performed consistently well in bull markets but have not collapsed in bear markets should be your focus.
- You can’t have it both ways. ✥