RBC Global Asset Management

INVESTOR INSIGHTS

What follows a market correction?

February 2022

On February 22, 2022 the S&P 500 entered correction territory, having closed down 10.1% from its last all-time high on January 3, 2022. A market correction usually draws a lot of attention when it happens. You may be wondering what it could mean for the months ahead. Looking at how financial markets responded following previous corrections may provide some insight.

What is a market correction?

A correction is usually defined as a decline of 10% or more from the most recent peak. A correction can happen to both individual stocks and to broader indices like the S&P 500. Compared to any one stock, a correction in the S&P 500 receives notably more attention as it indicates a large basket of stocks are down all at the same time. Whether a market correction is a sign of more to come is a different question.

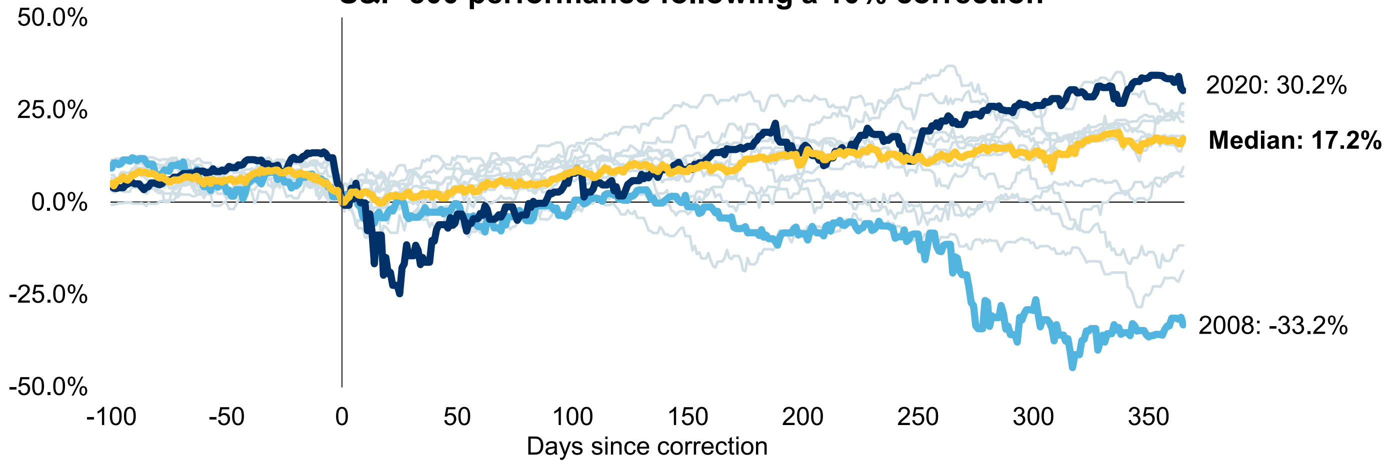
What happened and what comes next?

Financial markets have experienced a challenging start to 2022. This has largely been driven by two factors:

- expectations that the U.S. Federal Reserve is gearing up to raise interest rates
- the Russian invasion of Ukraine

Having now entered a correction, it's natural to ask where equity markets might be headed. A correction can either be brief or last for a period of time. However, the average market correction is usually short lived. To provide you added perspective, the below graph shows the history of S&P 500 corrections back to 1988 and what happened during the 365 days following each correction. Highlighted are the best (2020), worst (2008) and median result.

S&P 500 performance following a 10% correction



Source: RBC GAM, Morningstar. For the period of 1988-2021, shows the S&P 500 TR Index USD 100 days preceding and 365 days following a correction of at least 10% from the index's previous peak. Day 0 represents the day the market closed down at least 10%. Each line represents a separate correction. The yellow line represents the median experience for the 12 corrections that occurred during the period. An investment cannot be made directly into an index. The table does not reflect transaction costs, investment management fees or taxes. If such costs and fees were reflected, returns stated would be lower. Past performance is not a guarantee of future results.

Key take-aways

For the 365 days following S&P 500 corrections of at least 10% between 1988 and 2021:

- The median return has been 17.2%.
- Returns have finished positive 75% of the time.
- Negative losses were only experienced following corrections during the 2000 tech bubble (twice) and the 2008 financial crisis. It's important to note that there were meaningful recession risk indicators entering both these periods. We do not have that same backdrop today.

Market corrections are more common than you may expect. There has been an average of roughly one every three years since 1988. Nonetheless, market volatility can still be stressful, particularly if you follow the markets day-by-day. It is important to remember that – all else equal – a decline in markets today adds to the return potential you can expect going forward. With that in mind, here is a quote to think about in the current market environment:

"It isn't investments that get tested in turbulent markets; it's investors."

- Jason Zweig, The Wall Street Journal[1]

Publication date: February 25, 2022

[1] Zweig, J. (2022, January 25). Why You Should Sit Out the Mayhem. *The Wall Street Journal.* https://www.wsj.com/articles/why-you-should-sit-out-the-mayhem-11643142839