

# WHY FEAR IS GOOD



CHARLIE BILELLO | COMPOUND CAPITAL ADVISORS

OCTOBER 3, 2022

*“Investors should remember that excitement and expenses are their enemies. And if they insist on trying to time their participation in equities, they should try to be fearful when others are greedy and greedy when others are fearful.” – Warren Buffett*

*“Greed, for lack of a better word, is good” – Gordon Gekko, Wall Street*

Fear and Greed.

The two emotions that dictate all of the short-term movements in markets.

During last year’s rolling series of manias, greed was the predominant force in markets, with the only fear amongst investors being the fear of missing out (FOMO). Prudence was an afterthought as investors were behaving as if the future already happened.

But that was 2021. Fast forward to today, and we’ve seen a 180 degree shift in sentiment, with fear taking over.

What changed?

Prices.

The S&P 500® Index has now fallen over 25% from its January high, the largest correction since March 2020 and the longest drawdown we’ve seen since the 2007-09 bear market.

## S&P 500® INDEX CORRECTIONS >5% SINCE MARCH 2009 LOW

Correction Period	# Days	S&P High	S&P Low	% Decline	"Stocks Fall On..."
2022: Jan 4 - Sep 30	269	4819	3584	-25.6%	Inflation, Rising Rates/Fed Tightening, Russia/Ukraine War, Recession Fears
2021: Nov 22 - Dec 3	11	4744	4495	-5.2%	Covid Omicron Variant, Fed Taper Fears
2021: Sep 2 - Oct 4	32	4546	4279	-5.9%	China Contagion Fears, Fed Taper Fears, Covid Delta Variant
2021: Feb 16 - Mar 4	16	3950	3723	-5.7%	Inflation Fears, Rising Rates
2020: Sep 2 - Sep 24	22	3588	3209	-10.6%	Coronavirus, No New Stimulus Deal, Election Fears
2020: Feb 19 - Mar 23	33	3394	2192	-35.4%	Coronavirus, Global Depression Fears
2019: Jul 26 - Aug 5	10	3028	2822	-6.8%	Trade War, Tariffs, Yuan Devaluation, Recession Fears
2019: May 1 - Jun 3	33	2954	2729	-7.6%	Trade War, Tariffs, Inverted Yield Curve, Global Slowdown/Recession Fears
2018: Sep 21 - Dec 26	96	2941	2347	-20.2%	Rising Rates, China Slowdown, Trade War/Tariffs, Housing Slowdown
2018: Jan 26 - Feb 9	14	2873	2533	-11.8%	Inflation Fears, Rising Rates
2016: Aug 15 - Nov 4	81	2194	2084	-5.0%	Election Fears/Concerns/Jitters
2015/16: May 20 - Feb 11	267	2135	1810	-15.2%	Greece Default, China Stock Crash, EM Currencies, Falling Oil, North Korea
2014/15: Dec 29 - Feb 2	35	2094	1981	-5.4%	Falling Oil, Strong Dollar, Weak Earnings
2014: Dec 5 - Dec 16	11	2079	1973	-5.1%	Falling Oil, Strong Dollar
2014: Sep 19 - Oct 15	26	2019	1821	-9.8%	Ebola, Global Growth Fears, Falling Oil
2014: Jan 15 - Feb 5	21	1851	1738	-6.1%	Fed Taper, European Deflation Fears, EM Currency Turmoil
2013: May 22 - Jun 24	33	1687	1560	-7.5%	Fed Taper Fears
2012: Sep 14 - Nov 16	63	1475	1343	-8.9%	Fiscal Cliff Concerns, Obama's Re-Election
2012: Apr 2 - Jun 4	63	1422	1267	-10.9%	Europe's Debt Crisis
2011: May 2 - Oct 4	155	1371	1075	-21.6%	Europe's Debt Crisis, Double-Dip Recession Fears, US Debt Downgrade
2011: Feb 18 - Mar 16	26	1344	1249	-7.1%	Libyan Civil War, Japan Earthquake/Nuclear Disaster
2010: Apr 26 - Jul 1	66	1220	1011	-17.1%	Europe's Debt Crisis, Flash Crash, Growth Concerns
2010: Jan 19 - Feb 5	17	1150	1045	-9.2%	China's Lending Curbs, Obama Bank Regulation Plan
2009: Oct 21 - Nov 2	12	1101	1029	-6.5%	Worries About The Recovery
2009: Sep 23 - Oct 2	9	1080	1020	-5.6%	Worries About The Recovery
2009: Jun 11 - Jul 7	26	956	869	-9.1%	World Bank Neg Growth Forecast, Fears Market Is Ahead Of Recovery
2009: May 8 - 15	7	930	879	-5.5%	Worries That Market Has Gotten Ahead Of Itself
<b>Median</b>	<b>26</b>			<b>-7.6%</b>	

Past performance is not indicative of future results. Source: Compound.

After 13 consecutive years of positive returns, the Nasdaq 100® is down 32% in 2022, giving back all of the gains from 2021 and more (back to October 2020 levels).

**NASDAQ-100® TOTAL RETURN LEVEL % CHANGE**



Past performance is not indicative of future results. Source: YCharts.

High-growth stocks (ARK Innovation ETF, \$ARKK) have been hit even harder, losing more than three-quarters of their value from peak 2021 levels.

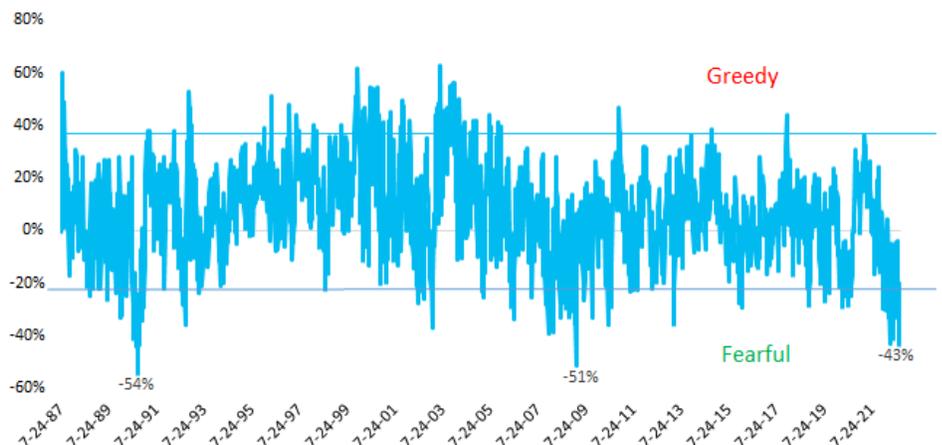
**ARK INNOVATION (ARKK) TOTAL RETURN PRICE % OFF HIGH**



Past performance is not indicative of future results. As of 10/4/22. Source: YCharts.

As prices have moved lower and the news has turned negative, sentiment has soured.

**AALL SENTIMENT SURVEY: % BULLS MINUS % BEARS (JULY 1987-SEPTEMBER 2022)**



Past performance is not indicative of future results. Source: Compound.

Bears now outnumber Bulls by over 43% in the AALL sentiment poll, which is among the most negative readings we've ever seen. With data going back to 1987, the only times sentiment was more bearish than today was in October 1990 (a 20% bear market bottomed that month) and March 2009 (the week of the bear market low).

For market participants, that's good news. For when investors are extremely fearful (bottom 3% of sentiment readings), forward returns have tended to improve, with above-average outcomes over the subsequent three-month through five-year periods. The opposite has tended to be true following periods of extreme greed (top 3% of readings).

Period: Weekly, Since 1987	S&P 500 Average Forward Total Returns					
AAll Sentiment (% Bulls minus % Bears)	3-Month	6-Month	9-Month	1-Year	3-Year	5-Year
Extreme Fear - Bottom 3% (<-28% Spread)	3.8%	9.5%	9.9%	12.3%	28.2%	89.6%
Extreme Greed - Top 3% (>40% Spread)	-0.8%	-0.6%	-0.2%	-1.1%	4.7%	16.2%
All Readings	2.7%	5.6%	8.8%	12.0%	26.0%	73.9%

Past performance is not indicative of future results. Source: Compound.

Is extreme fear *a/ways* followed by positive returns?

No. There's no such thing as always in markets, and, in the short run, anything can happen. Throughout 2008 and early 2009, many bearish sentiment extremes were hit only to be followed by lower lows ahead (typically with bounces in between). We've seen a similar pattern this year, with persistent bearish sentiment starting back in January and a number of dead cat bounces along the way.

Still, if given the choice between a period marked by extreme greed or extreme fear, long-term investors should always prefer the latter. Why? Because extreme fear creates the opportunity to add capital at lower valuations and a more favorable balance between risk and reward. On the other side, extreme greed inevitably leads to poor decision making, chasing higher risk securities with little long-term reward.

Which is why when it comes to investing it is not greed but fear that is good.



To learn more, please contact us at 800-243-4361 or visit [virtus.com](http://virtus.com).

The **S&P 500® Index** is a free-float market capitalization-weighted index of 500 of the largest U.S. companies. The index is calculated on a total return basis with dividends reinvested. The **Nasdaq-100®** includes 100 of the largest domestic and international non-financial companies listed on the Nasdaq Stock Market based on market capitalization. The index is calculated on a total return basis with dividends reinvested. The indexes are unmanaged, their returns do not reflect any fees, expenses, or sales charges, and are not available for direct investment.

All investments carry a certain degree of risk, including possible loss of principal.

**Not insured by FDIC/NCUSIF or any federal government agency. No bank guarantee. Not a deposit. May lose value.**

Distributed by **VP Distributors, LLC**, member FINRA and subsidiary of Virtus Investment Partners, Inc.