INVESTING INVESTING ESSENTIALS

Bull Market

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What Is a Bull Market?

A bull market is the condition of a financial market in which prices are rising or are expected to rise. The term "bull market" is most often used to refer to the stock market but can be applied to anything that is traded, such as bonds, real estate, currencies, and commodities.

Because prices of securities rise and fall essentially continuously during trading, the term "bull market" is typically reserved for extended periods in which a large portion of security prices are rising. Bull markets tend to last for months or even years.

KEY TAKEAWAYS

- A bull market is a period of time in financial markets when the price of an asset or security rises continuously.
- The commonly accepted definition of a bull market is when stock prices rise by 20% after two declines of 20% each.
- Traders employ a variety of strategies, such as increased buy and hold and retracement, to profit off bull markets.

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Understanding Bull Markets

Bull markets are characterized by optimism, investor confidence, and expectations that strong results should continue for an extended period of time. It is difficult to predict consistently when the trends in the market might change. Part of the difficulty is that psychological effects and speculation may sometimes play a large role in the markets.

There is no specific and universal metric used to identify a bull market. Nonetheless, perhaps the most common definition of a bull market is a situation in which stock prices rise by 20%, usually after a drop of 20% and before a second 20% decline. Since bull markets are difficult to predict, analysts can typically only recognize this phenomenon after it has happened. A notable bull market in recent history was the period between 2003 and 2007. During this time, the S&P 500 increased by a significant margin after a previous decline; as the 2008 financial crisis took effect, major declines occurred again after the bull market run.[1] [2]

Characteristics of a Bull Market

Bull markets generally take place when the economy is strengthening or when it is already strong. They tend to happen in line with strong gross domestic product (GDP) and a drop in unemployment and will often coincide with a rise in corporate profits. Investor confidence will also tend to climb throughout a bull market period. The overall demand for stocks will be positive, along with the overall tone of the market. In addition, there will be a general increase in the amount of IPO activity during bull markets.

Notably, some of the factors above are more easily quantifiable than others. While corporate profits and unemployment are quantifiable, it can be more difficult to gauge the general tone of market commentary, for instance. Supply and demand for securities will seesaw: supply will be weak while demand will be strong. Investors will be eager to buy securities, while few will be willing to sell. In a bull market, investors are more willing to take part in the (stock) market in order to gain profits.

Bull vs. Bear Markets

The opposite of a bull market is a bear market, which is characterized by falling prices and typically shrouded in pessimism. The commonly held belief about the origin of these terms suggests that the use of "bull" and "bear" to describe markets comes from the way the animals attack their opponents. A bull thrusts its horns up into the air, while a bear swipes its paws downward. These actions are metaphors for the movement of a market. If the trend is up, it's a bull market. If the trend is down, it's a bear market.

Bull and bear markets often coincide with the economic cycle, which consists of four phases: expansion, peak, contraction, and trough. The onset of a bull market is often a leading indicator of economic expansion. Because public sentiment about future economic conditions drives stock prices, the market frequently rises even before broader economic measures, such as gross domestic product (GDP) growth, begin to tick up. Likewise, bear markets usually set in before economic contraction takes hold. A look back at a typical U.S. recession reveals a falling stock market several months ahead of GDP decline.

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Market Mentalities: Bulls Vs. Bears

How to Take Advantage of a Bull Market

Investors who want to benefit from a bull market should buy early in order to take advantage of rising prices and sell them when they've reached their peak. Although it is hard to determine when the bottom and peak will take place, most losses will be minimal and are usually temporary. Below, we'll explore several prominent strategies investors utilize during bull market periods. However, because it is difficult to assess the state of the market as it exists currently, these strategies involve at least some degree of risk as well.

Buy and Hold

One of the most basic strategies in investing is the process of buying a particular security and holding onto it, potentially to sell it at a later date. This strategy necessarily involves confidence on the part of the investor: why hold onto a security unless you expect its price to rise? For this reason, the optimism that comes along with bull markets helps to fuel the buy and hold approach.

Increased Buy and Hold

Increased buy and hold is a variation of the straightforward buy and hold strategy, and it involves additional risk. The premise behind the increased buy and hold approach is that an investor will continue to add to their holdings in a particular security so long as it continues to increase in price. One common method for increasing holdings suggests that an investor will buy an additional fixed quantity of shares for every increase in the stock price of a pre-set amount.

Retracement Additions

A retracement is a brief period in which the general trend in a security's price is reversed. Even during a bull market, it's unlikely that stock prices will only ascend. Rather, there are likely to be shorter periods of time in which small dips occur as well, even as the general trend continues upward. Some investors watch for retracements within a bull market and move to buy during these periods. The thinking behind this strategy is that, presuming that

the bull market continues, the price of the security in question will quickly move back up, retroactively providing the investor with a discounted purchase price.

Full Swing Trading

Perhaps the most aggressive way of attempting to capitalize on a bull market is the process known as full swing trading. Investors utilizing this strategy will take very active roles, using short-selling and other techniques to attempt to squeeze out maximum gains as shifts occur within the context of a larger bull market.

Bull Market Example

The most prolific bull market in modern American history started at the end of the stagflation era in 1982 and concluded during the dotcom bust in 2000. During this secular bull market—a term that denotes a bull market lasting many years—the Dow Jones Industrial Average (DJIA) averaged 15% annual returns.[3] The NASDAQ, a tech-heavy exchange, increased its value five-fold between 1995 and 2000, rising from 1,000 to over 5,000. A protracted bear market followed the 1982-2000 bull market. From 2000 to 2009, the market struggled to establish footing and delivered average annual returns of -6.2%. However, 2009 saw the start of a more than ten-year bull market run. Analysts believe that the last bull market started on March 9, 2009, and was mainly led by an upswing in technology stocks.

Why Is It Called a "Bull" Market When Prices Go Up?

The actual origin of the term "bull" is subject to debate. The terms "bear" (for down markets) and "bull" (for up markets) are thought by some to derive from the way in which each animal attacks its opponents. That is, a bull will thrust its horns up into the air, while a bear will swipe down. These actions were then related metaphorically to the movement of a market. If the trend was up, it was considered a bull market. If the trend was down, it was a bear market.

Others point to Shakespeare's plays, which make reference to battles involving bulls and bears. In "Macbeth," the ill-fated titular character says his enemies have tethered him to a stake but "bear-like, I must fight the course." In "Much Ado About Nothing," the bull is a savage but noble beast. Several other explanations also exist.

Are We In a Bull Market Now?

Generically, a bull market exists if the market has risen 20% or more above its near-term lows. Since the dramatic market sell-off during the 2008-09 financial crisis, the stock market has shown a resilient bull market, rising significantly, and reaching new all-time highs more than ten years after that market crash (despite some sharp pullbacks along the way).

What Makes Stock Prices Rise in a Bull Market?

Bull markets often exist side-by-side a strong, robust, and growing economy. Stock prices are informed by future expectations of profits and the ability of firms to generate cash flows.

A strong production economy, high employment, and rising GDP all suggest profits will continue to grow, and this is reflected in rising stock prices. Low interest rates and low corporate tax rates also are positive for corporate profitability.

Why Do Bull Markets Sometimes Falter and Become Bear Markets?

When the economy hits a rough patch, for instance in the face of recession or spike in unemployment, it becomes difficult to sustain rising stock prices. Moreover, recessions are often accompanied by a negative turn in investor and consumer sentiment, where market psychology becomes more concerned with fear or reducing risk than greed or risk-taking.

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