Buying the Dip

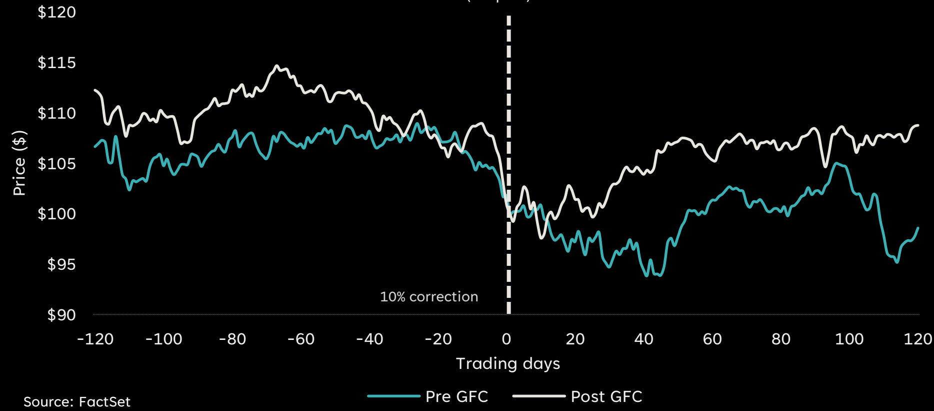
Since early August, global equities have experienced significant volatility. In the first half of the month, over 90% of global equity markets saw drawdowns exceeding 5%, with more than 40% experiencing corrections of over 10%. Despite this, most indices has since rebounded, trading near their all-time highs. As September, historically the weakest month for equities, began, markets faced similar drawdowns amid ongoing growth concerns. However, equity markets shrugged off these worries, buoyed by a 50-basis point rate cut from the Federal Reserve, pushing them back towards record levels.

Goldman Sachs' research highlights that drawdowns are a regular feature of equity markets, though their size and frequency vary. Smaller drawdowns occur roughly half the time, while larger ones, often coinciding with recessions, are rarer. Over the past century, the S&P 500 has experienced drawdowns of more than 20% approximately every 4-5 years. However, bear markets have become less frequent in recent years. The 1990s saw the longest equity bull market, driven by structural tailwinds and the Tech Bubble. The post-GFC cycle was also notably extended, with three significant S&P 500 drawdowns nearing bear market territory: the Euro area crisis in 2011 (-19.4%), the EM/oil crisis in 2015 (-14.2%), and the Q4 2018 drawdown (-19.8%).

Despite these fluctuations, the "Buy the Dip" strategy has been highly effective since the 2008 financial crisis (GFC). Analysis of the MSCI World price index movement 120 trading days before and after a 10% correction reveals two key trends: 1) the post-GFC recovery period is significantly shorter than the pre-GFC era, 2) and the recovery level indicates that this strategy has outperformed since the 2008 crisis relative to the period before the GFC. While the adage "time in the market beats timing the market" holds true, our analysis indicates that for investors with available cash looking to increase their portfolio risk, historically since 2008, a 10% pullback in equity prices has presented a lucrative entry point.

MSCI World price corrections since 1990 (50th Percentile)

(Graph 1)



Source: FactSet

Frequency of drawdowns (rolling 12 months) – Since 1973

Drawdown ranges	U.S.	Euro Area	UK	Germany	Japan
0% - 5%	58%	40%	52%	42%	39%
5% - 10%	18%	23%	22%	23%	19%
10% - 20%	15%	21%	17%	20%	25%
> 20%	9%	16%	10%	15%	16%

% of drawdowns in recessions – Since 1973

Drawdown ranges	U.S.	Euro Area	UK	Germany	Japan
0% - 5%	26%	33%	29%	42%	62%
5% - 10%	39%	37%	48%	53%	59%
10% - 20%	58%	41%	43%	55%	71%
> 20%	69%	58%	55%	71%	85%

Source: Goldman Sachs

Buy the Dip strategy

To assess the efficacy of the “Buy the Dip” strategy, we analysed historical forward returns following 10% market corrections dating back to 1990. Graph 2 illustrates the average returns over various holding periods post-correction. A stark contrast emerges between the pre- and post-2008 financial crisis eras.

Post-GFC, the data reveals two key trends: 1) higher average returns and 2) a significantly increased hit rate (positive returns over the period). This shift can be attributed to the so-called “Fed put,” where the Federal Reserve’s intervention during market stress aimed to fulfil its dual mandate, particularly the maximum-employment objective.

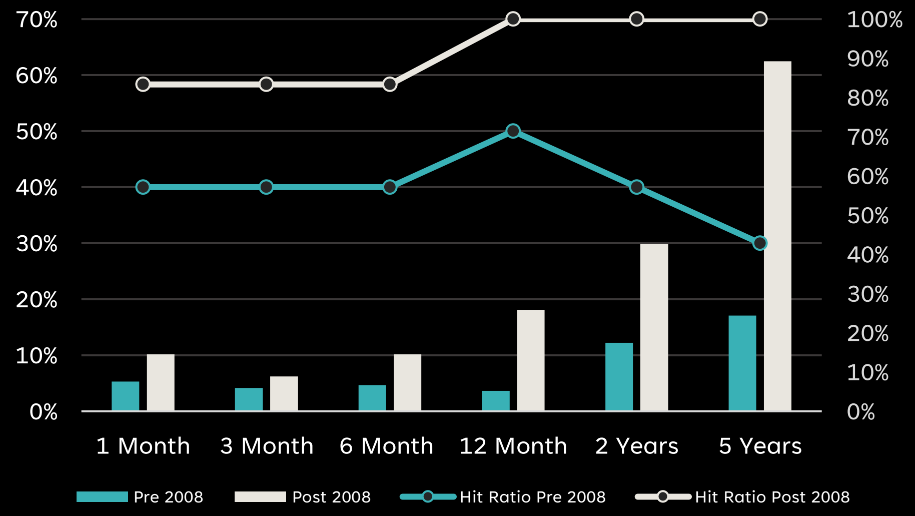
The viability of buying the dip hinges on the persistence of equity drawdown risks. Post-drawdown, improved asymmetry often arises as valuations drop and sentiment turns bearish, though further macroeconomic and market deterioration remains a risk. Equity drawdowns can tighten financial conditions, impacting macro momentum. Optimal conditions for adding risk typically follow substantial declines in sentiment, positioning, or valuations, regardless of subsequent macro conditions.

The Fed’s reaction function in a high-inflation environment, such as in 2022, prompted investors to reassess the fair value of risk assets and numerous academics released articles noting that “buy the dip” is dead. However, recent inflation data suggests that inflation concerns have waned, shifting focus to growth. Despite a 50-basis point rate cut in September, the Fed retains sufficient capacity to intervene should the market encounter turbulence.

The “Buy the Dip” strategy has garnered significant attention over the past decade, with research indicating its effectiveness. A pronounced drop in stock prices can present a lucrative investment opportunity, provided investors can pinpoint the right moment and the right dip to capitalize on. However, it’s crucial to remember that no single indicator can guarantee a sound investment decision, and this strategy is no exception to this principle.

Buy the dip strategy statistics

(Graph 2)



Source: FactSet

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