BULLSEYE Highlights

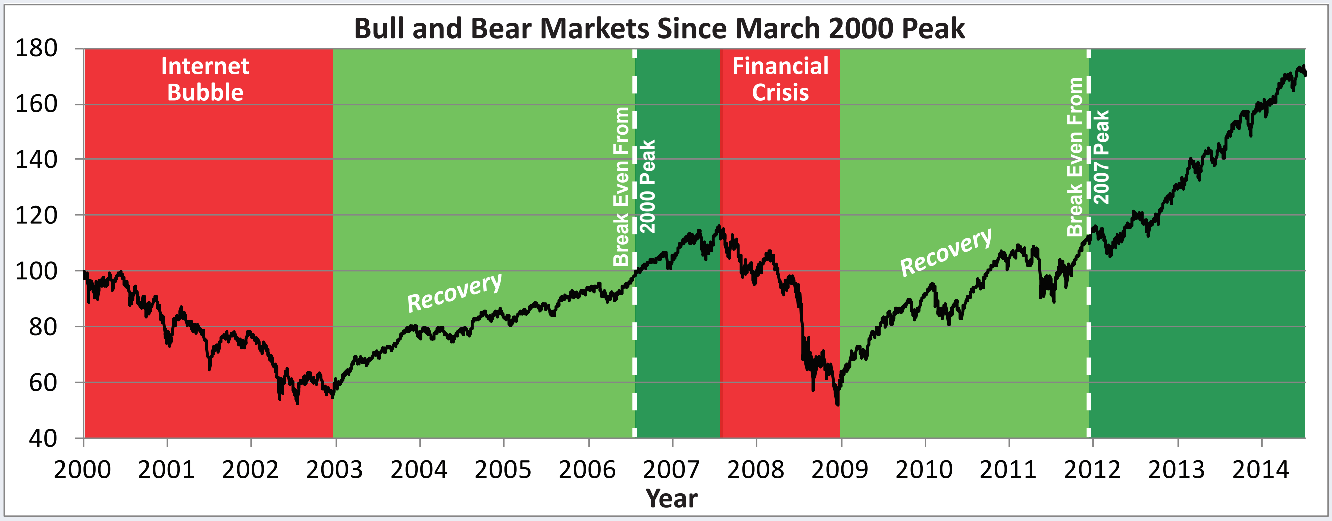
Scare Markets

Most people know about bull markets and bear markets, but may not be familiar with "scare markets"—bull markets that briefly disguise themselves and scare investors into thinking it's the start of a bear market. These scare markets are more commonly referred to as temporary market corrections.

Corrections are generally understood to be short-term market losses lasting only a few days, weeks or perhaps a few months. The drawdown from the peak to the lowest point may be significant, perhaps in the 5% to 15% range, before rebounding upward. These corrections can be caused by a number of circumstances, but the key factor is that the period is generally brief and the losses are quickly recovered. Bear markets are longer-term periods that can last several months and even years, with declines of 20% or more. The recovery time back to the breakeven point can take quite some time in a true bear market.

So how can an investor tell the difference between a bear market and a scare market? Without the benefit of hindsight, it's impossible to say with certainty. But there are some tell-tale signs at the heart of every scare market. Scare market corrections are often driven by the fear of uncertainty and potential problems with the markets, whereas bear markets tend to be caused by actual problems with the markets.

Since the year 2000, there have been two significant bear markets: the "Internet Bubble" (early 2000-2003) and the "Financial Crisis" (late 2007-2008). Those two bear markets had something in common—they were caused by actual fundamental problems with the financial markets. Ultimately, both of those bear markets were followed by significant bullish recovery periods, but it took some time to get back to even.

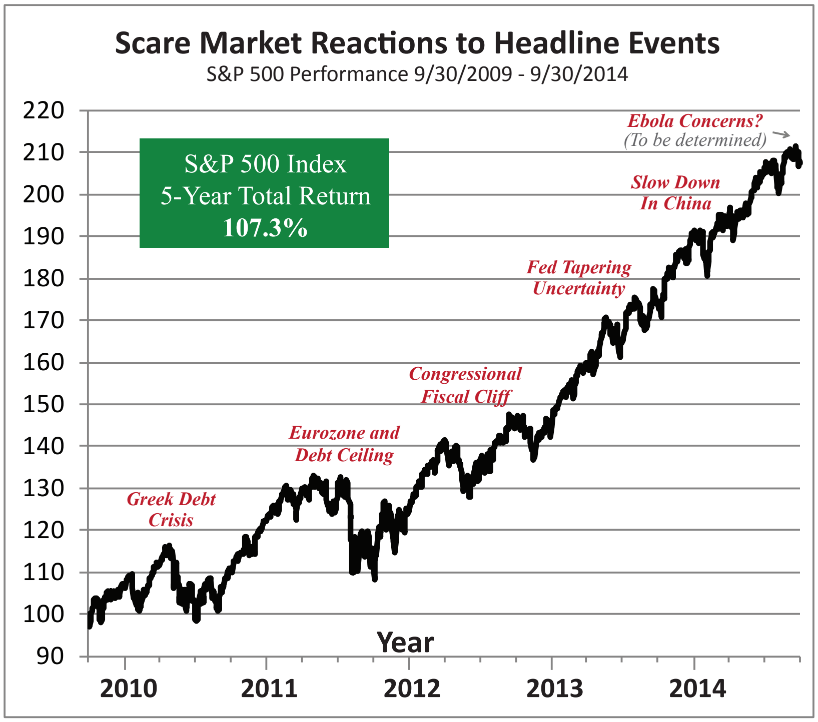


Past performance is no indication of future returns. *S&P 500 Total Return Index data from 3/24/2000 through 9/30/2014. Index performance assumes reinvestment of dividends, but does not include fees. Indexes are not available for direct investment. Data source: FactSet, calculated by Arrow.*

The difference with these two bear markets was the fact that they both reflected genuine issues with stock market valuations. Rather than being the result of over-reaction to unrelated non-financial headlines, the financial markets were the headline. The Internet Bubble reflected a widespread realization that market valuations were over-inflated and a company's ability to make money actually matters.

After the dust settled from the Internet Bubble (2000-2003), there was a five-year run-up lasting from March 2003 through September 2007. Once the markets finally got back to even, the Financial Crisis hit almost right away, starting from a peak set in October 2007. This time the markets reacted to a cascade of global financial issues that crossed virtually all asset classes, including stocks, bonds, real estate and commodities. The threat of financial turmoil was a real and immediate issue, not just hyperbolic headline fear.

Since the Financial Crisis ended in early 2009, the markets have rallied quite well, surpassing the old 2007 peak by the end of 2011. By 2012, the recovery bull market had turned into a new bull market with new all-time highs. Despite finally breaking through the old highs set in 2007, there were still several scare markets during the post-Financial Crisis run. Some academics consider a correction to be 5%, while others don't consider it a correction until the decline reaches 10%. So if we split the difference and analyze pullbacks of 7.5% or more over the past five years, there are several notable scare market corrections. Past performance is never an indication of future returns and the benefit of hindsight always makes this exercise easier to address once news events have become history. But as the saying goes, those who fail to learn from history are doomed to repeat it.



Drawdown Period From the Peak-to-Bottom	**% Decline** From the Peak-to-Bottom	**# Days to Breakeven** After the Initial 7.5% Decline	**1-Year Return** After the Initial 7.5% Decline
1/19/2010 - 2/8/2010	-8.03%	5	**27.87%**
4/23/2010 - 6/8/2010	-12.76%	76	**20.49%**
6/18/2010 - 7/2/2010	-8.44%	7	**33.46%**
7/22/2011 - 10/3/2011	-17.91%	66	**34.50%**
10/28/2011 - 11/23/2011	-9.41%	6	**24.05%**
4/27/2012 - 6/1/2012	-8.68%	18	**31.27%**

Past performance is no indication of future returns. *S&P 500 Total Return Index data from 9/30/2009 through 9/30/2014. Index performance assumes reinvestment of dividends, but does not include fees. Indexes are not available for direct investment. Data source for the graph and table: FactSet, calculated by Arrow.*

The accompanying graph and table illustrate some of the scare markets that have occurred during the past five years. The graph shows the ups and downs of the stock market (S&P 500) and identifies some specific news events that may have contributed to market scares. The table shows the hypothetical results if an investment were made as soon as a 7.5% drawdown occurred and the resulting one-year return after that point. Since nobody can predict an exact bottom, drawdowns certainly can continue well beyond the initial 7.5% decline, as one would expect. So the table also shows how long it would have taken to get back to even if an investor had bought on the initial 7.5% dip, but still had to endure a further decline.

Buying on the Dips: There is no way to know if a drawdown is going to be short-lived or not. However, there is an obvious difference between a news-driven market scare and a fundamental bear market. Some would argue that brief market corrections are normal, and perhaps, even a sign of market health. Without corrections, bull markets can run out of control based on "irrational exuberance" and build to an over-inflated point—similar to the burst of the Internet Bubble of the late 1990s and the bear market that followed. Periodic corrections give the market a chance to take a breath and gather itself, while also providing investors with an opportunity to buy on the dips.