Types of Stock Market Corrections and Recoveries

Stock market corrections, typically defined as a 10%+ decline from peak, and bear market 20%+ decline, can take various shapes based on the pattern of decline and recovery.

- **V-Shaped:** A sharp decline followed by a quick, strong rebound to pre-decline levels or higher, resembling a "V."
    - ***This is the most common and optimistic scenario***, often driven by temporary shocks with rapid resolution.
        - Covid-19
        - Tariffs '24

- **U-Shaped:** A prolonged decline with a flat or gradual bottom, followed by a slow recovery, resembling a "U."
  - ***This occurs when structural issues take time to resolve*.**
    - ’08 GFC (*Monthly-Time Frame*)

- **W-Shaped:** A decline, partial recovery, then another decline (double-dip), before final recovery, resembling a "W."
  - This reflects volatility or renewed shocks.
    - ’08 GFC *Sometimes debated as U or W-shaped recovery due to double-dip fears.*

- **L-Shaped:** A sharp decline followed by prolonged stagnation at low levels, resembling an "L."
    - ***This is the rarest and most pessimistic, indicating permanent damage.***
        - 1929 Great Depression

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Recovery Shape Frequencies:

- **V-Shaped**: Most frequent, occurring in ~60-70% of post-WWII recessions and most market corrections.
  - Historical analysis shows an average of 1.8 V-shaped recoveries per year in the stock market (across environments like downturns, corrections, and bull markets).
    - Of 12 "waterfall" declines (sharp drops) since WWII, nearly all had V-shaped recoveries. Not increasing in frequency despite recent examples like COVID; more common in high-volatility periods.
- **U-Shaped:** ~20-30% of recessions (e.g., 3 out of 13 post-WWII).
  - Common in structural crises; average recovery time 1-2 years post-trough.
- **W-Shaped**: Rare, ~10% (1-2 major instances post-WWII). Probability increases with policy uncertainty.
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- **L-Shaped**: Near 0% for broad US markets; more common in individual stocks (e.g., NKE/NVO) or non-US cases.

Probabilities:

- A 10% correction has ~80% chance of deepening to 13%, 48% to 15%+, but shape-wise, ~70% chance of V-recovery if no recession (per historical patterns).
- In recessions, V-shape probability ~50-60% (stronger if shock is temporary); U/W higher if fundamental (e.g., 40%).
  - ***V is "normal" per economic history.***
- Average bear market decline: -32% (with recession), recovery +61% over 2 years post-trough.