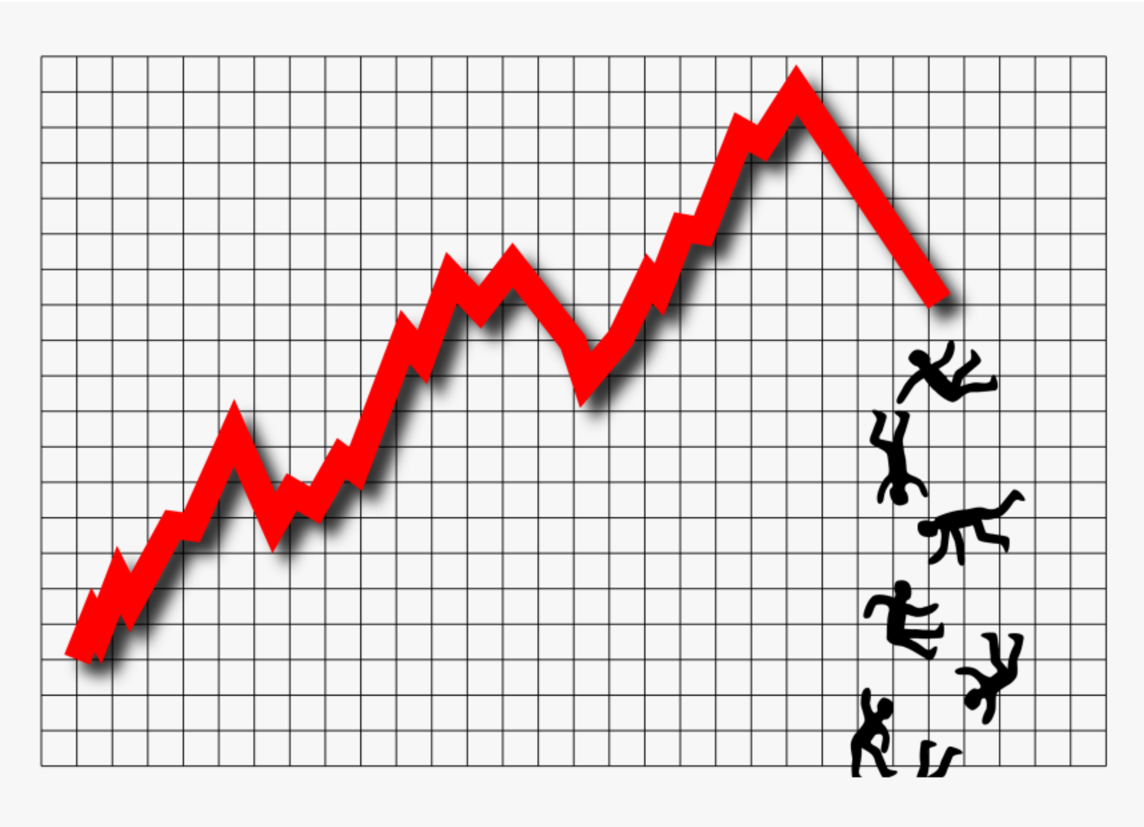
How Far Can the S&P 500 Drop? A Data-Driven Look at Market Corrections and what is the probability?

Market Overview: Where Are We Now?



The S&P 500 has declined from its peak of 6,000 to 5,538, marking a 7.7% drop. Historically, a market correction is defined as a 10% decline from a recent peak.

Since 1929, there have been 56 corrections, with only 22 evolving into bear markets (20%+ declines). This means about 60% of corrections stabilize before reaching bear territory. Reuters

Given the current decline, the market is approaching correction territory.

Trump-era tariffs (2018-2019) introduced a new dynamic in market behaviour, and their return under a second Trump administration could follow a similar pattern—or deviate based on new conditions.

Trump Tariffs (2018-2019) & Market Impact

- **Initial Tariffs (2018):**
    - March 2018: First tariffs on steel (25%) & aluminium (10%).
    - July 2018: $34B in tariffs on Chinese goods → **S&P 500 dropped ~6% in 3 weeks**.
    - **Market reaction:** Short-term volatility, but no major crash due to strong earnings & tax cuts offsetting trade fears.
- **Escalation (2018-2019):**
    - Sept 2018: $200B more tariffs → Market fell **~10% correction** (peak to trough).
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    - May 2019: Tariff hike to 25% on $200B Chinese goods → **S&P dropped ~6.5% in May**.
    - **Total 2018 correction:** ~20% (due to tariffs + Fed rate hikes).
- **Key Takeaway:**
    - **Tariffs alone didn't cause a bear market**, but they amplified volatility.
    - Markets **recovered quickly** when trade talks progressed (e.g., Dec 2018 bounce after G20 truce).

How Much Further Could It Drop?

1. Historical Trends

Market pullbacks and corrections follow a pattern:

Type of Decline	Average Drop	Frequency
Pullback (5%-10%)	~7%	Several times per year
Correction (10%-20%)	~13%	About once every 1-2 years
Bear Market (20%+)	~35%	Every 3-5 years

2. Current Decline (7.7% Drop from Peak)

- The S&P 500 is currently in a **mild pullback** (not yet a full correction).
- If this turns into a **standard correction (10-20%)**, potential downside:
    - **10% drop → 5,400**
    - **15% drop → 5,100**
    - **20% drop (bear market) → 4,800**

3. Could 2024-2025 Tariffs Change This Pattern?

Trump has proposed:

- **10% across-the-board tariffs** on all imports.
- **60%+ tariffs on Chinese goods**.
- Possible retaliation from EU/China.

Bull Case (Mild Impact, Like 2018-2019):

✅ **If tariffs are phased in slowly** & exemptions granted (like 2018).
✅ **Strong corporate earnings** offset higher costs.
✅ **Fed cuts rates**, easing market pressure.
➡️ **Market reaction:** Brief 5-10% dip, then rebound.

Bear Case (Worse Than 2018):

❌ **If tariffs spark a global trade war** (China/EU retaliate aggressively).
❌ **Inflation surges**, forcing Fed to stay hawkish.
❌ **Earnings decline** due to supply chain disrupt

3. Probability of a Deeper Decline

- **50-60% chance: Reaching a 10% correction (historically common).**
- **30-40% chance: 15%+ decline, depending on economic conditions.**
- **20-30% chance: full bear market (20%+ drop) if recession risks materialise.**

4. Key Risk Factors Influencing Further Drops

- **Fed Policy:** If the Fed remains hawkish (higher rates for longer), equities could struggle
- **Earnings Growth:** Weak earnings may accelerate selling.
- **Geopolitical Tensions:** Escalations (e.g., Middle East, Ukraine, Tariff reactions) or supply chain disruptions could create further volatility.
- **Valuations:** The S&P 500 remains expensive, with a Shiller P/E of ~33 (vs. a historical average of ~17).

5. Worst-Case Scenario?

- In **severe bear markets** (2008, 2020, 2022), drops reached **30-50%**.
- If this happens, levels to watch:
  - **25% drop → 4,500**
  - **30% drop → 4,200**
  - **35% drop → 3,900**

Bottom Line

- **Most Likely Outcome:** A 10-15% correction (5,400-5,100) is plausible.
- **Bear Market Probability:** A 20%+ drop (4,800 or lower) remains possible but less likely unless a recession hits.
- **Rebound Potential:** If the Fed cuts rates or earnings remain strong, the market could recover quickly.

Investor Takeaway

Volatility is part of investing. Watching economic indicators and maintaining a balanced portfolio can help navigate uncertain times.

Take advice from your trusted professional before acting.