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The Delta variant could thwart the recovery that has driven stocks to record highs. 2 market experts describe their strategies for profiting regardless of what happens — including the likelihood of a 20% crash.

A 20% selloff isn't as unlikely as investors may hope. Tetra Images/Getty Images

- **Peaking growth and the potential for bond purchase tapering by the Federal Reserve are big risks.**

- **A 20% drawdown could temporarily derail stocks' gravity-defying run from pandemic lows.**
- **Bank of America and BCA Research strategists describe how to prepare for a market pullback.**

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the stock market's breathtaking rally and could trigger a 20% pullback, but Bank of America is still cautiously optimistic on equities in the long term.

The US' fastest recession on record was quickly followed by an accelerated economic rebound and a furious market rally. Risk assets rebounded twice as fast as in the past, wrote strategists led by Andy Pham, a fixed income instruments, currencies, and commodities quantitative strategist at BofA, in an August 4 note. But that's all the more reason to be cautious.

"A normalization of the impressive recovery would require either lower average returns, higher volatility, or the combination of the two moving forward," Pham wrote.

Ninety years of history shows — without fail — that investors should expect a substantial drawdown of about 20% in the first two years of an economic expansion, Pham wrote.

Peaking economic and earnings growth as well as the possibility of early bond purchase tapering by the Federal Reserve could spark the selloff, the note read. Surging Delta variant COVID-19 cases, underwhelming US fiscal policy, and persistent inflation are also risks.

But predicting the timing of a serious correction is impossible and not worth attempting, Pham wrote. Risk assets like stocks have historically rebounded from those pullbacks and were higher two years later on both a cumulative and risk-adjusted basis.

"Even investing at the absolute highs before recovery drawdowns has shown that time in the market can save mis-timing the market," Pham wrote. "... Our suite of quantitative signals and models show that trend remains lofty for US equities and most commodities as markets continue to march higher despite growing anxiety around growth risk."

Though the Delta variant is concerning and US growth may have peaked, there are far more reasons to be bullish on stocks than bearish, wrote Doug Peta, chief US investment strategist at BCA Research, in a recent report.

"As long as the spread of the Delta variant does not lead to punishing new restrictions, the economy will continue to grow at an extremely rapid clip, and the strong-growth, easy-policy backdrop will continue to support equities and credit." Peta wrote. "... Deceleration from way, way above the long-run potential growth rate to way above it is not cause for concern."

Some anxious investors have noted that the sharp drawdown in bond yields — which move inversely to prices — in recent months indicates that expectations for strong growth are fading.

The massive rally in US 10-year Treasury Notes, which pushed yields under 1.2% from 1.6% in early June, was a surprise, Peta wrote, before adding that he expects the rally to reverse. BCA Research expects the 10-year yield to finish the year above 1.75%.

"It seems like the rally in long-dated Treasuries can be attributed to an unwinding of inflation fears, concerns about slowing growth and the reversal of a Treasury sell-off that had gone too far, too fast," Peta wrote.

Investors took note of the remarkable recovery and sold bonds, deducing that rampant inflation would soon follow. That sent bond yields soaring 90% from early January through late March. Sentiment has now reversed as the narrative shifts to concerns of lackluster future growth.

Inflation won't hurt the economy for the foreseeable future, Peta wrote, adding that investors may get antsy this fall if high consumer price index readings cast doubt on whether or not inflation is truly "transitory." Bonds would sell off if the Fed announced it was pumping the brakes on bond buying.

Meanwhile, stocks have been choppy lately despite remarkably strong earnings that should crush expectations for the fifth straight quarter, Peta wrote.

But investors should stay long risk assets and ride the wave of positive sentiment and friendly Fed policies, the note read, barring an unforeseen growth slowdown, inflation spike, or series of pandemic-induced lockdowns.

Staying the course may be boring compared to calls for market crashes, Peta wrote, but there's currently no justification for deviating from the tried-and-true method of staying long stocks.

"There is no reason to expect a recession when households are sitting on $2.4 trillion of excess savings, household net worth has advanced at the fastest rate on record, retail inventories have been depleted to record-low levels, and payrolls are set to continue expanding at a furious rate over the next year-plus," Peta wrote.