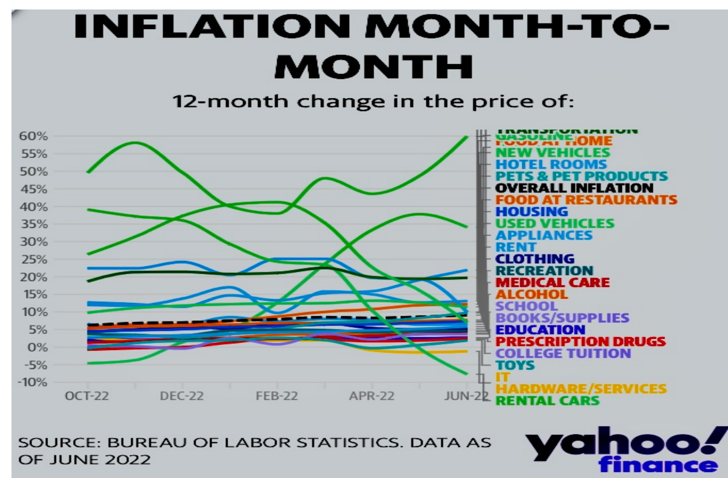
We Entered a Bear Market in June, so, What Does this Mean for the Balance of '22?

By Bob Deitrick CEO of Polaris Financial Partners, LLC

July 15th, 2022

We entered a bear market on June 13th. The S&P 500 closed today at 3,863 after we saw a terrible headline inflation number this Wednesday of 9.1%.[1] The lowest point so far in this cycle was a month ago at 3,666.17 on June 16th. We have had six different 5%+ bear market rallies this year, none of which have halted the slide that began in January.[2]

So, what do we attribute this bearish activity to? Greed, incompetence – incompetence and greed. We have seen it by Vladmir Putin who invaded the Ukraine in February sending oil prices soaring. Our leadership in the White House was caught totally flat-footed on inflation and has had no effective response so far. The Fed has been a day late and a dollar short for years. The expectations on the pandemic provided by the Biden administration were overly inflated and underachieved. Inflation has not been fleeting as the Fed and Jay Powell conveyed. Our government pumped too much money into the economy in response to Covid creating the recipe for a Perfect Storm which we have witnessed since January.



There has been a plethora of bad news on inflation this year. This bear market will likely last longer than the one in March of 2000 as the Fed is posturing to continue their rate hikes to rid the economy of inflation. The last bear market started at the beginning of the pandemic in March of 2020 and lasted only 33 days. That was the shortest bear market in history.[3] The longest bear market occurred during the 2007 to 2009 financial crisis which persisted almost 18 months. We do not see that happening here; however, how long this bear market persists will be a function of what happens to inflation and gas prices and whether the Fed can jam up inflation to prevent a recession. There is an awful lot of uncertainty in the market today, and as we have shared with you many times - the market loathes uncertainty. The good news is that the job market remains robust which makes this very different from the crisis of '08.

What happens to the markets though when consumer sentiment gets weak? Let's look back historically:

Sentiment Sinks	S&P 500 in Next 12 Months
July 2022	?
April 2020	+44%
August 2011	+15%
November 2008	+22%
October 2005	+14%
March 2003	+33%
May 1980	+22%
February 1975	+11%

Source: JP Morgan

So, before we dread everything going on - let's walk back into history for a moment and look at the markets and why those predicting this is the same as 1980 are wrong:

- ***How often does the stock market go down? Often. The market goes down on average, 5% at least once each year.*** [4]
- ***The market goes down 10% every one to two years.*** [4]
- ***The market goes down 20% every 4 to 6 years.*** [4]
- ***But, how much has the stock market gone UP over the long term?***
- ***40 of the past 50 years, the stock market has appreciated 80% of the time or 4,569% over 50 years. Not a bad return over time.*** [4]
- ***The Fed Funds rate was raised last month by 75 basis points to 1.75%.*** [5]
- ***The Fed Funds rate was raised by 500 basis points in February of 1980 to 20%?*** [5]
- ***Then it was lowered a few months later in May to 11.5%. The Reagan bull market of 1982 that lasted over five years was started when the fed funds rate was at 9.5%!*** [5]

There is no comparison of the present day to the inflation and recession cycle of the early 1980's.

So, why shouldn't we try to time the market to achieve a higher rate of return you might ask? That is a great question, and the answer is simple - market timing does not work - here's why: [6]

Decade	Return if you missed the best 10 trading days in the decade	Actual Return for the decade
1930	-79%	-42%
1940	-14%	+35%
1950	+167%	+257%
1960	+14%	+54%
1970	-20%	+17%
1980	+108%	+227%
1990	+186%	+316%
2000	-62%	-24%
2010	+95%	+190%

So, where are the big Wall Street strategists predicting the market will wind up at the end of 2022? Despite the anemic first half that we have seen to date, 23 major Wall Street firms, including Morgan Stanley (3900), Goldman (4300), BofA and Merrill Lynch (4500), Barclays (4500), Citi (4700), UBS (4850), Fundstrat at 5100, and Oppenheimer (5300) believe we will be higher by year end. The mean of these 23 Wall Street firms is an estimate of 4617 by year end. That's 26%+ above where the market is this week. [7]

Will this latest rebound in stocks last? Not likely. This week's headline inflation report looking back to June was a quick tell of what the immediate future holds. With headline inflation coming in at 9.1% for June, inflation has not subsided although it has likely peaked. Commodity futures have been crushed in the last few weeks, and that portends inflation has peaked. Citigroup Bank, where our friend and former intern, Justin Braun works, predicts oil will also collapse and drop to $65 per barrel this winter. That bodes well for gas prices and stocks as inflation will recede if this takes place.

Each market rally this Spring has been a faux bear rally. The key moving forward will be what happens to core inflation and how the Fed reacts? Because the Fed has so little credibility today, we suspect they will remain hawkish in 2022. However, once inflation subsides, we will see improvement in the markets. Could things get worse, of course, but this is not the 1980's when the Fed Funds rate was six to ten times higher than it is today! Presently we expect the market to be higher at the end of the year relative to where it is today, but we may revisit new lows before moving up again.

The S&P 500 is now 16-times its 12-month forecast earnings. It's not a generational bargain, but down about as much from the valuation peak as retrenching markets have been. This chart below shows the degree of valuation adjustment is a picture of optimism escaping equities.

Source: www.insight.factset.com

As with many historical patterns that we have seen over the years, today's pattern creates the probability to favor good returns looking out months from now even though stocks just had their worst half-year in a generation.

Let's look at both cases as we look over the market for the next six months into 2023:

We believe that the market may retest and hit new lows this summer as some stocks remain in existing downtrends, but there is the possibility that the market will rebound in the second half of '22. Many analysts portend that the "right parts" of the economy are weakening and that means the Fed may not have to be as hawkish as originally planned. The big question is will earnings weaken by inflation or not.

Since the May CPI report came out on June 10th, commodity prices have started to roll over, real estate prices are slowing down, and rents are cooling. Gasoline futures are down 25% - that will show up at the pumps in a few weeks so gas is likely coming down and we may see gas prices back down to $3.50 per gallon by early fall.[8] If that transpires, consumer sentiment will likely improve going into the all-important Christmas shopping season.

If we do have a slow-down in the economy, as predicted, and the Fed pivots, we could have a reasonable finish to the year and a good start to 2023. Time will tell. We will make strategic moves in accounts when we believe the market has bottomed and take advantage of oversold stocks with strong balance sheets.

So, when will the market bottom? The market bottoms when the public throws in the towel. Based on history, that is what is happening now. According to legendary technician Larry Williams, the market is due for a rebound in August. Williams believes commercial hedge funds managers in stock futures, which are mainly banks, mutual funds, and governments, tend to have the best understanding of their industry compared to professional money managers and average investors. "When the hedge fund guys get very bullish in their positioning - it's often a great buying opportunity" - according to Williams. When the market gets to a key bottom, as we have done recently, William's points out that "the commercial hedge managers tend to be bullish, while the large speculators, money managers, and the public, tend to be bearish. [9]

The question over the next few months is how aggressive is the Fed is going to have to be to curb inflation which has been rampant all year. Grocery prices, groceries, airline tickets and everything have gone up at a pace we have not seen in more than a generation. A Dave's Single Value Meal at Wendy's today now which was $5.99 last year now costs $8.50 and the same value meal in St. Croix is $13.00!

Investment Advisory Services are offered through Cadaret, Grant & Co. Inc., or Polaris Financial Partners, LLC, Registered Investment Advisors. Securities are offered and sold through Cadaret, Grant & Co., Inc., Member FINRA/SIPC. Polaris Financial Partners, LLC and Cadaret, Grant & Co., Inc. are not associated entities. Past performance is not indicative of future result

The views expressed here are those of Bob Deitrick and do not necessarily reflect those of Cadaret, Grant & Co., Inc. The information in this article is current at the time of this writing. It is based upon sources and data believed to be accurate and reliable. Opinions and forward-looking statements expressed are subject to change without notice. Investing is subject to risks, including loss of principal invested.

[1] https://www.bls.gov/news.release/cpi.htm

[2] https://finance.yahoo.com/quote/%5EGSPC/history?p=%5EGSPC

[3] *https://awealthofcommonsense.com/2021/02/a-short-history-of-u-s-stock-market-corrections-bear-markets/*

[4] *https://money.com/stock-market-correction-chart/*

[5] *https://www.thebalance.com/fed-funds-rate-history-highs-lows-3306135*

[6] https://www.cnbc.com/2021/03/24/this-chart-shows-why-investors-should-never-try-to-time-the-stock-market.html

[7] *https://www.marketwatch.com/story/what-big-wall-street-banks-say-about-where-the-s-p-500-will-end-2022-11657571886*

[8] https://finance.yahoo.com/quote/RB%3DF/history?p=RB%3DF

[9] https://www.cnbc.com/amp/2022/07/11/jim-cramer-says-the-market-could-see-pleasant-surprises-going-forward.html