

Dear Clients and Friends,

Glad to see July 1st roll around! Good riddance to that first half of 2022, which saw an unexpected bear market rear its ugly head with the S&P 500 stock index down 20.7% in the first half. The 2022 bear market has one similarity to the pandemic induced bear market of 2020 in that the bearish condition was caused by one outlier event. In 2020 the event was the pandemic and 2022's event was the Russian invasion of Ukraine. Both bear markets are similar in their downside intensity. Regarding duration, the 2020 bear market was short, lasting less than 2 months, while the 2022 bear market is now six months old and showing many signs of maturity.

Signs of maturity? What??? The news is portrayed as terrible and getting worse. Aren't we going into a recession? And those gas prices? And mortgage rates are now 6%!!! The world is falling off its axis! How can the bear market be ending?

Technical signs of the imminent end of the 2022 bear market are abundant. I have summarized some of these indications below:

1. **Markets are "stretched" to the downside.** There is a symmetry in market behavior over long periods of time. As the bull market plowed ahead during 2020 and 2021, the S&P 500 stock index stretched to a point of 17% higher than its 200-day moving average (Dec. 8 2020). At the 2022 market low (S&P 500 index of 3667 on June 16), the S&P 500 closed at a level of 16.8% **below** its 200-day moving average, an interesting example of market symmetry. Another example of downside "stretch" is that on June 1st, 1% of the stocks trading on the New York Stock Exchange were trading above their 20-day moving average, a rare occurrence last seen in March 2020 and in the depths of the 2008-2009 bear market. Conclusion: the market may have reached its maximum "stretch" to the downside.
2. **Evidence of institutional "buy" programs.** I'll quote from master technician Joe Granville's description of late bear market behavior (written in the 1960s):

"The market continues to make new lows as the negative news continues to worsen and even become more negative. The professional super-bears are at their peak of their popularity - lecturing, giving seminars, writing books, and otherwise preaching a thesis of economic Armageddon, and the public is now eating it up. Late in this phase many stocks *stop going down*. Evidence of that will be a maximum number of individual new lows recorded followed by a *diminishing number* as the Dow continues to make new lows. The profound change underway as the third phase of the bear market gets started is that the smart money is making the great transition from pessimism to confidence at the same time the public shifted their psychological stance from confident to pessimistic."

Six major institutional "buy programs" have been observed in the six-week period ending in mid-June, illustrating the conversion to optimism by large-money-interests as observed by Granville. A "Zweig Thrust" buy signal was generated in May that indicates a rapid rush (within several trading days) of large-scale buy-side interest, with this signal interestingly occurring during the 6-week period of institutional buy programs.

3. **Investor sentiment is abnormally negative.** "The American Institute of Individual Investors" sentiment survey is a weekly survey of its members which asks if they are bullish, bearish or neutral on the stock market for the next 6 months. The ratio of bears to bulls has hovered at a ratio of 3-1 (+/-) for many months now. I have followed this sentiment pool for most of my career and note that this lopsided bearish sentiment has rarely been recorded, especially for a multi-month time period. The CNN "fear and greed index" is at its most extreme level, illustrative of extreme bearish sentiment. The guys in my "old men's tennis league" seemed to be exceptionally bearish this morning, alerting me to be on the look-out for a market turn.

4. **More Extremes.** During the current bear market, the number of NYSE stocks trading more than 20% below their 52-week lows has hit a level of 74%, lining up favorably with extremes of the Q4 2018 mini-bear market (78%), and mini-bears Oct. 2011 (77%) and Feb. 2016 (71%). The bear markets of 2001-2002 and March 2020 registered readings of 83% and 97%, so it is not out of the question that the 2022 bear reaches those metrics.
5. **The Volatility Index (VIX).** The volatility index is a measurement of expected volatility within the next thirty days. A high VIX reading (over 20) indicates that fear dominates investor sentiment; a low VIX reading (less than 20) indicates investor complacency. After registering an extreme high reading of over 35 in March, the VIX closed at 26.7 on July 1. The July 1st reading is indicative of much fear still present in the market. A market rally that coincides with a rapid drop in the VIX to below 20 would be very bullish for the stock market.

Fundamental Factors. I discussed various topics above which are considered to be technical, in nature. Technical analysis, by definition, is an analysis of market and pattern behavior based on “non-fundamental” factors. Below, I discuss numerous factors which are fundamental such as economic growth, interest rates, earnings prospects, etc.

1. **News.** The current financial news as reported by most national media outlets is bad. Reporting bad news is good for ratings. That’s how news is reported these days. It’s bad and getting worse. One time-honored adage of bear-market bottoms is that “you get bottoms when the news is bad, there is never good news at bottoms. Good news starts to appear only after the new bull market is well underway”.
2. **Interest Rates.** The Federal Reserve Board increased the federal funds rate by .75% to 1.75% in June. This is bad news, right? Not necessarily. I would point out that the last time the federal funds rate increased by .75% was in November 1994. The rate was increased to 5.5% at that time. The stock market rallied strongly from that point until the end of 1999 in one of the greatest bull runs in market history. So, higher interest rates are not necessarily bearish, especially if the peak in rates is in sight. The Fed is likely to increase by another .5% in July. Perhaps then, the tightening cycle may be nearly over. That would be a bullish development for the stock market.
3. **Inflation.** Much attention is being given to rising inflation trends. Rising inflation has caused the Federal Reserve Board to raise interest rates and to end quantitative easing. But, is inflation showing signs of peaking? Many commodities have been falling in price in recent weeks. For example, the following commodities have fallen in price below their respective 52-week highs: Crude oil – 13%, Natural gas – 32.9%, Copper – 24%, Aluminum – 36.9%, Steel – 42.1%, Lumber – 57.7%, Cotton – 36.8%, Wheat – 27.2%, Soybean Oil – 25.1%, Oats – 24.9%, Lean Hogs – 15.3%. The housing market is showing signs of cooling off, as mortgage rates have nearly doubled in recent weeks. Recently, I have seen some price decreases in the ultra-hot market of Naples, FL. Inflation could be peaking, which would be bullish for the stock market.
4. **Recession.** Bear markets occur prior to the start of recessions, and they end prior to the end of recessions. The “rule of thumb” definition of recessions is two consecutive quarters of declining GDP (Gross Domestic Product). GDP was negative 1.6% in the first quarter, 2022, and it would not be unreasonable to project a negative GDP in Q2, 2022, signaling that we are already in a recession. Since new bull markets always start before the end of recessions in the face of bad economic news, then wouldn’t it seem to fit that the market could be bottoming *right now* in advance of the end of recession during the 3rd quarter?
5. **Corporate Earnings.** Earnings have rebounded sharply since the onset of the pandemic and the short recession that accompanied it. Consensus earnings projections for the subsequent 12 months peg the price-earnings ratio for the S&P 500 index to be 16.5 times forward earnings. Earnings haven’t been this “cheap” since 2011. Earnings growth may level off in a slower economy, but in the big scheme of things large corporate entities are using advancements in technology on a massive scale to improve efficiency and profitability. I wouldn’t bet a lot on declining earnings.

Bob Farrell’s “Rules”. Bob Farrell is a legendary long-time technical analyst whose career with Merrill Lynch spanned nearly 50 years. During his career he developed 10 key stock market rules to live by, 2 of which are especially pertinent now.

1. **Bob Farrell’s rule number 1:** “Markets tend to return to the mean (average price) over time.” As noted above, during the bull phase of 2020-21, the S&P 500 traded at a level 17% over its 200-day moving average (the mean), before falling to a level nearly 17% below its 200-day moving average. We should expect the S&P 500 to return to its 200-day moving average and likely beyond it, when the current downtrend runs its course.... according to Mr. Farrell’s rule no 1. The S&P 500 stock index currently trades at 15% below its 200-day moving average.
2. **Bob Farrell’s rule number 2:** “Excesses in one direction will lead to an opposite excess in the other direction.” The 2022 decline has been abnormally intense to the downside. We should expect an equally intense move to the upside when the current downtrend runs its course.... according to Mr. Farrell’s rule no. 2.

A history of market returns following bear market bottoms is illustrated in the chart below. This is a summary of all bear markets since 1950 and the history of returns following the final bottom of each bear market. The one-year returns following each bottom present *eye-popping* returns within the range of **29% to 71%**. **So, this illustrates the importance of being “in the market” at the point of a bear market low.**

Start	End	Index Start	Index End	Secular or Cyclical?	Duration			% Decline	6 Months Later	1 Year Later	5 Years Later	10 Years Later
					Years	Months	Days					
10/11/07	3/6/09	1,576.09	666.79	Secular	1	4	23	-57.69%	52.43%	70.77%	181.50%	315.64%
3/24/00	10/10/02	1,553.11	768.63	Secular	2	6	16	-50.51%	13.39%	35.05%	103.28%	86.38%
1/11/73	10/4/74	121.74	60.96	Secular	1	8	23	-49.93%	32.68%	40.99%	80.73%	167.24%
12/2/68	5/26/70	109.37	68.61	Cyclical	1	5	24	-37.27%	24.02%	45.15%	32.02%	61.22%
8/25/87	10/20/87	337.88	216.46	Cyclical	0	1	25	-35.94%	18.32%	30.68%	91.94%	341.47%
2/19/20	3/23/20	3,393.52	2,191.86	Cyclical	0	1	4	-35.41%	47.68%	78.41%		
12/12/61	6/25/62	72.64	51.35	Cyclical	0	6	13	-29.31%	23.89%	36.40%	79.16%	110.85%
11/26/80	8/9/82	141.96	101.44	Cyclical	1	8	14	-28.54%	42.94%	57.86%	218.41%	312.93%
1/4/22	6/17/22	4,818.62	3,636.87	Cyclical	0	5	13	-24.52%				
2/9/66	10/10/66	94.72	72.28	Cyclical	0	8	1	-23.69%	22.08%	33.98%	37.47%	41.89%
7/20/98	10/8/98	1,190.58	923.32	Cyclical	0	2	18	-22.45%	45.56%	44.70%	11.96%	6.67%
7/15/57	10/22/57	49.13	38.98	Cyclical	0	3	7	-20.66%	9.80%	31.02%	41.00%	144.69%
7/17/90	10/11/90	369.00	294.00	Cyclical	0	2	24	-20.33%	28.23%	29.59%	97.10%	364.15%
9/21/18	12/26/18	2,940.91	2,346.58	Cyclical	0	3	5	-20.21%	24.17%	38.07%		

To summarize the main points of this commentary:

- Markets are “stretched” to the downside.
- Significant institutional “buy programs” are noted.
- Extreme levels of sour investor sentiment line up with past bear market bottoms.
- News is always bad at stock market bottoms.
- Interest rates may not increase much more.
- Inflation may be moderating.
- Corporate earnings are still strong – the market PE ratio is now low.
- Markets will revert to the mean over time.
- Intense declines are followed by intense rallies.
- Market returns in one year following market bottoms are significant; we are close to a significant market bottom.

Happy Fourth of July! Have a nice Summer!