21st Century
Equity Advisors Corporation

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Year-End 2022 Commentary
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Dear Clients and Friends,

BACK TO THE DRAWING BOARD

The main theme of my July commentary was that the end of the 2022 bear market was imminent. I discussed numerous reasons that included: 1) Maximum "stretch" to the downside, 2) Evidence of institutional "buy" programs, 3) Abnormally bearish investor sentiment, 4) Continuous stream of bad news (always present at bear market bottoms), 5) Panic and fear levels were abnormally high. As of the end of 2022, it is not clear that a brand new bull market has yet started, although we may be in the early stages of a new bull market if the October 13th low are not broken. In the past few weeks, I've had quite a few observations concerning the current state of the stock market bouncing around in my head. I would like to share those with you now.

<u>STOCK MARKET PERFORMANCE – 2022</u>. A capsule summary of stock market performance for 2022:

- For the year, the S&P 500 Index fell by 19.6%, or 17.6% considering the effect of dividends.
- From an all-time high S&P 500 Index of 4,797 registered early in January, the S&P 500 Index fell by 20%, or 18% considering the dividend effect.
- The closing low for the S&P 500 Index occurred on October 12th at 3,577, 25.3% from its early-January high. In the first hour of trading on October 13th, the S&P 500 Index fell to 3,500, or 27% from its all-time high of early January. This metric, the S&P 500 Index being down 27% from its high, is the statistic I will use to define the severity of the 2022 bear market to date.

<u>HISTORY OF PAST BEAR MARKETS</u>. As of year-end, the S&P 500 index is trading 9.7% higher than the low established on October 13th. So, if the market were to remain above the Oct. 13th low of 3,500 and rise 20% to 4,200, then the low set on that date would be defined as the low watermark for the entire 2022 bear market.

A summary of the history of defined bear markets since 1929:

- There have been 24 bear markets since 1929, not including the current bear market.
- The duration of those bear markets fell within the following ranges (number of days): 1 to 200-11, 201 to 400-4, 401 to 600-5, more than 600-4.
- The magnitude of bear market loss expressed in terms of "percentage down" is as follows: less than 25%-8, 25% to 35%-8, 35% to 45%-3%, more than 45%-5.

Note that 63% of those 24 bear markets ended in less than 400 days; 67% ended with losses less than 35%. The current 2022 bear market, if still in progress, is 355 days old, with a maximum drawdown of 27% so far.

<u>THE 1982 BEAR MARKET BOTTOM</u>. Proof positive that I am in urgent need of more hobbies, I found myself reading the minutes of "The Federal Reserve Board's Open Market Committee" meetings held on July 1, 1982, July 15, 1982 and August 24, 1982. My curiosity got the best of me, I guess. The reason that I selected those particular minutes from that period in history is that they summarized Federal Reserve Board actions right at the point of the beginning of the most prolific BULL market in history, August 12, 1982. At the time, the United States was experiencing the worst level of inflation and highest interest rates in its history. The Federal Reserve Board had been raising interest rates for several years in the Board's quest to kill raging inflation. The occurrences of high inflation along with high interest rates resemble today's environment, although the magnitude of the problem was much greater in 1982. At

the exact point of the new, emerging bull market, August 24 1982, the unemployment rate had just increased to 9.8% (today it is 3.7%); the Open Market Committee agreed to seek higher growth in the money supply to stimulate the economy that was in recession; inflation was moderating as compared to 1981; GPD growth was negative for the first half of 1981; market interest rates had declined significantly (the federal funds rate, for example, declined from around 14.5% at the end of June 1982 to about 10% in the statement week ending August 18th). The fuel for the monster bull market that began on August 12th clearly was that of peaking inflation and lower interest rates as the economy was still weak. Using the 1982 environment as a benchmark for 2023, it would be positive for the stock market when interest rates stop rising and that recent signs of moderation in inflation continue. The next 3 Federal Reserve Board meetings are scheduled for Jan 31st, March 22nd and May 2nd. It is generally expected that the Federal Reserve will raise interest rates by .25% three more times in 2023. Each meeting could result in an explosive stock market rally with just the right comments concerning a potential pivot away from monetary tightening spoken by Chairman Powell.

MARKET TECHNICALS. The stock market was in a weakened technical condition as 2022 came to a close. New 52-week lows for the major stock indices have expanded in recent weeks and advance-decline lines are very near to their bear market lows as S&P 500 index is 9.7% over its 2022 low. This is a negative divergence that points to an eventual retest of the October 13th low. Also, many leading stocks (referred to as "bell-weathers") are exhibiting breakdown price patterns in recent months. Examples include Apple (AAPL), Amazon (AMZN), Tesla (TSLA), Microsoft (MSFT), Google (GOOG) all of which are in firm entrenched downtrends.

NEGATIVE INVESTOR SENTIMENT/ GREAT VALUES PRESENT THEMSELVES AT BOTTOMS. Investor sentiment at the moment is unusually sour and has been throughout most of 2022. To a man, the CNBC analysts are bearish, at least short-term. I note that a recent reading of the 10-day average Put-Call ratio stood at 1.25, indicative of lopsided bearish sentiment, the extent of which was last seen at the March 2020 pandemic lows. My inclination is not to be a part of a crowd that large. In other words, the entire investment universe is leaning in one direction, a condition that you see near to major stock market bottoms.

You also see great fundamental stock market values at major bottoms. This is the "ah-ha" moment that arrives every so often when stocks have been driven down so far, that valuations become irresistible. Intel at $26/sh. with earning capacity of $6+/sh. and a 5% yield, for example? Who would have thought?

THE PRESIDENTIAL CYCLE. The stock market is now in the 3rd year of the 4-year presidential cycle pattern. The stock market rises during 3rd years of presidential terms nearly all of the time. The reasoning is that the party in power has a vested interest in presiding over a growing economy as the next election is not that far off. Could that be the case again this year? The bullish scenario is that the pattern of interest rate hikes and quantitative tightening come to an end in the first half of 2023 and the economy begins to show signs of growth again.

Summary: my thought is that the market could bounce around still for a number of months. Oversold rallies could be impressive, but a re-test of the October 13th low is likely to be in the cards. No need to get overly ambitious yet, I think. An overall strategy of buying equities within a 5% range on either side of that October 13th low of 3,500 should prove to be a winning strategy. According to that parameter, the "buyer's band" would be the S&P 500 area of 3,325 to 3,675.

Happy Holidays! John Hegler