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MARKET ETHOS

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Two Months Into the Bear?

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We don’t think so, but we do admit it is possible. Starting first with economics, the world often does not know it is in a recession until many months after it starts. A recession is commonly defined as two consecutive quarters of negative GDP growth and the reporting of GDP occurs a month after the end of the quarter. Add it up, confirmation comes seven months after the recession started. Thanks economists, that is really helpful! And we are ignoring how many times economic data gets restated afterwards. Same scenario for the recovery when we see reports indicating the recession has ended many quarters after it actually has.

The equity markets moving from bull to bear to bull again suffer from a similar delay, albeit with less of a lag. On October 12th,2007, nobody knew the previous day was the market top for that cycle. Just like on March 7th, 2009 nobody knew a brand new bull had started. So today, with the S&P 500 down 10% from its high set on January 26, could we be two months into a bear? Again, no one know until much later from now (that isn’t helpful). All we know with certainty is that the market is now oscillating back in forth flirting with correction territory. No doubt the S&P 500 chart does not look very encouraging (chart to the right). In speaking with our in-house market technician, the failure of the rebound to reach new highs and subsequent failure back through both the 50- and 100-day moving averages are not a good sign. In terms of key levels of support, we have two adjacent levels nearby, the low close in February of 2,580 and the 200-day moving average at 2,585 remain key levels to watch. It’s also worth noting these are only a couple of percentage below current levels. If you ask any technician, they will say that you need price and volume to confirm any change in market trends. As it stands, the charts are lining up to see a potential double bottom. Should support hold, this is a good sign as it’s often a solid reversal pattern following several months of down markets. The previous lows were set six weeks ago, and bottoms often take some time to form. Patience is tough, but the reward is often worth it.

Lots of fundamental news is to blame for the weakness. The primary recurring culprit remains bond yields. The markets are having a hard time adjusting to the ten-year Treasury yield of 2.8-2.9% and for good reason. This cycle has seen yields remain low and artificially depressed for an extended period. Too long in fact. This has increased the market’s sensitivity to

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Expectations Are Inflating

The Bell Has Been Rung

Hey Equity Markets, Bond Yields Toll for Thee

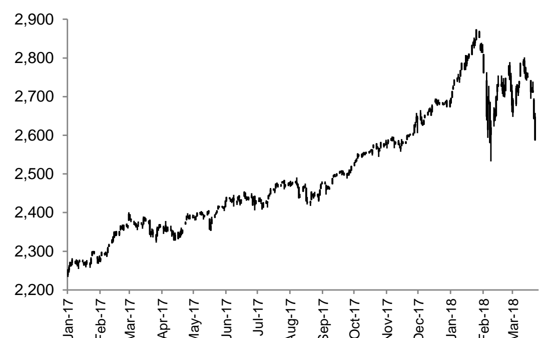
Dollar will make you holler

Growth vs Value & your age

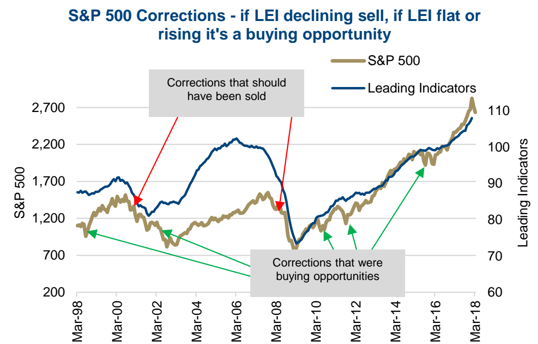
Managing your biases

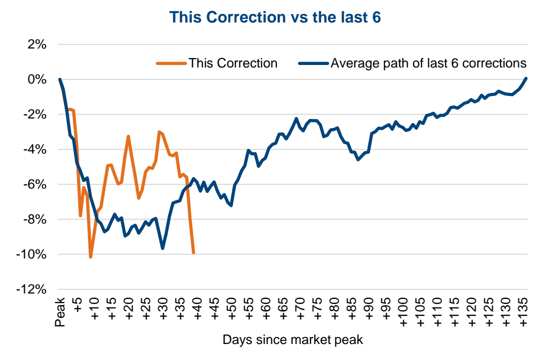
Stars Remain Aligned

S&P 500 - not a very encouraging chart



changes in bond yields, resulting in a more interest rate sensitive market in general. The Fed meeting last week, which saw rate hike as expected, also contained language that the economy is doing well and there is more to come. Perhaps more than the market liked. Add to this, the decline and mounting concerns over Facebook. Normally, one company would not have an impact, but this is one of the leaders during this cycle which makes it more important. Then finally there is the ongoing tariff / trade issues. Add it up and you have a market that is having trouble absorbing this much negative news.





Bull vs Bear

This is the late stage of the current bull cycle with just about all of the classic characteristics in place. Unemployment is low and decreasing, narrowing market leadership and the Fed steadily raising rates. That in itself does not mean the end of the cycle is imminent, in fact this stage of the cycle often sees some of the biggest gains for equity markets. It also sees heightened volatility as the bull and the bear fight it out to see who will carry the day. History says the bull usually wins but the times when the bear wins, are not kind to investors.

We continue to be in the camp the recent market weakness is a correction and at some point the negative news will subside for long enough to see the market gain some confidence. Market Cycle indicators remain extremely positive, meaning the underlying fundamentals, economic data, risk metrics remain more encouraging for a continuation of the bull.

The Leading Economic Indicators (LEI) is provided by the Conference Board and captures ten indicators that have historically been good at predicting future economic activity. Historically, if the S&P 500 weakens during periods that the LEI is either flat or rising, these have been very good buying opportunities. Conversely, market weakness when LEI is declining, have very poor times to add capital to the equity markets. The good news at the moment is the LEI is rising and rising nicely (top chart). This does provide additional evidence this is more of a correction and not a change from bull to bear.

Can past corrections/market weakness tell us anything?

Sadly, not too much but there are some patterns. The chart bottom right contains the average path for the S&P 500 in the six major market pullbacks since 2010. Double bottoms have been rather common which we could have put in on Friday as the market is really bouncing today. Plus, from a duration perspective, we are past the average point of the trough. Again, averages can be misleading.

Conclusion

Given the market cycle, leading indicators, potential double bottom, duration of weakness, this does look like a buying opportunity. But as we said at the beginning of this edition, there is a chance it is the 2nd month of a new bear market.

Charts are sourced to Bloomberg unless otherwise noted.

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