MARKET MONITOR

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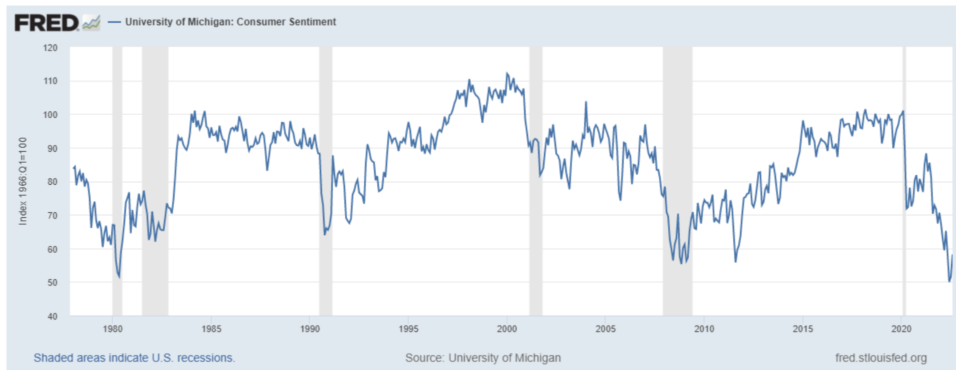
Searching for a Bear Market Bottom is a Sign the Selling isn't Over

BY: MICHAEL ALEXENKO, CFA

When we're in the throes of a painful bear market, it's understandable that we search for signals for when the selling will be exhausted. Oddly, when there are still many curious investors searching for a bear market bottom it's probably a good indication that the desire for selling hasn't been satiated. At least, so say the smug investment gurus on Wall Street, who refer to this as a *contrarian indicator*. In consideration of the bear market bottom question, the idea is that a bear market doesn't end until sentiment is so bad that no one cares to ask when the end will be because they no longer have interest in a stock market that only guarantees losses.



Wall Street worships data so much that its created infinite charts or graphs in an attempt to measure our emotions. In the case of investor psychology or sentiment readings we aren't left to contemplating if there are still too many people wondering about the end of the bear market, since we have readings like: Consumer Confidence, Consumer Sentiment, Investor Sentiment, Market Sentiment, Fear and Greed index and NFIB sentiment surveys and the list goes on. What these gauges are telling us is that the psychological moods of investors and consumers are at sour levels not seen since the Great Recession, and in the case of Consumer Sentiment it not long ago hit at an all-time historical low. Using Wall Street's contrarian indicator rule this would tell us that we have to be close to a market bottom because seemingly everyone has already thrown in the towel.

Remember the meme stock craze that caused huge runups in stocks like AMC Entertainment and GameStop? Those stocks are now down 90% and 70% respectively from their 2021 highs. At the time these stocks were enjoying obsession from the millennial day trading crowd there were many on Wall Street, especially the short sellers of those stocks, who were griping that stimulus checks were being used by millennials who were "working from home" and had time and money on their hands to play the stock market. The professionals were correct that this was a signal that the market was getting too much artificial juice from sloppy fiscal and monetary policy and that the overall stock market looked ripe for a correction. Although few predicted that the correction would turn into the bona fide bear market that it has.

It turns out that after the market has been dropping for a while, millennials who hated greedy Goldman Sachs short sellers, are now themselves shorting the market. This means they are betting that the market will continue to drop and they want to make money on our misery. At least that's how they portrayed short sellers when Gamestop and AMC were being shorted. Does this mean that the tide is beginning to turn and as the individual investors place big bets that the market will continue to drop, that it's a signal the market will start to go higher? It sure does seem like a good contrarian indicator, but it doesn't answer the question when it will happen. Maybe, that time is now?

Possibly we should forget about all the psychological analysis and get down to doing some number crunching, because that is the business we are in when we put our dollars on the line. Using the numbers, we see that prior to the pandemic the S&P 500 was trading at about 3,300 and some argue that the pre-pandemic level is where the market hits fair value. The S&P 500 now trades are 3,640 or about 10% above the pre-pandemic trading range. Hmmm, does another 10% down from here seem like a reasonable level for the market to bottom? And when you calculate that the stock market was trading at a rich price of 22X forecasted earnings when the economy seemed strong, it

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would be logical that the market should trade at a lower multiple when the economy has some serious injuries. Some claim a 15X multiple is warranted and that 2023 earnings will come in at $200 so doing that math gets us to an S&P 500 of 3,000.

Others say that average bear markets go down by 35% and last for 289 days which would mean that the market bottoms at S&P 3,118 and should do so soon because the one we're in has eclipsed the 270 day mark.

Another possibility is if we know for sure that we are still in the long-term bull market that started in March 2009, then we could expect a bear market of 27.5% down that ends after 229 days. This means the market bottoms at 3,500 but we are far past the duration that should have stopped in August. The severity of bear markets is more intense if the market and economy are in a long-term downtrend, so knowing if we have entered a new long term downtrend is not an insignificant fact if we want to get our timing accurate.

Other plans of attack might be to buy the market when the dollar stops going up or when the Federal Reserve says it will stop raising rates. Unfortunately, the gurus on Wall Street will likely draw conclusions about these two indicators long before others and you'll miss the first 10% of a market rally before you know that it is happening.

It should be clear from this article that we can arrive at several different targets for market lows and getting the time and price target both correct have the same chance as 00 coming up on the roulette table in consecutive spins.

This investment advisor's approach is to identify what level of risk a client is able to tolerate and then modify that risk for projected outcomes. Current conditions suggest that less portfolio risk is still best, but to keep most stock positions in place because missing the big bounce off the bottom is a near certainty if you get caught trying to pick a bottom.

Market Snapshot:

Market Worries - Too Much Fed Action will Hurt the Economy

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What has made this bear market for stocks worse than others is the simultaneous occurrence of a bond bear market. How many times have you heard the statement, "*I'm invested in U.S. Treasury bonds that have no risk*?" As of the writing of this newsletter long term U.S. Treasury bonds are down 30% year-to-date. That kills the riskless investment fantasy. So, we're suffering with a market where stocks, real estate, precious metals and bonds are all down big, leaving us no safe havens with the possible exception of energy. The Federal Reserve is determined to prove its inflation fighting mettle and the fear is that they'll overdo the battle against trimming inflation fat and start cutting into the economy's muscle.

The best outcome, which is not a low probability, is that inflation has already started to subside. If so, this will begin to show up in the next three reports before year end and the Fed will declare victory, which results in the market celebrating with a major pop. Regrettably, recent price action suggests that the market believes that the Fed will carve muscle and that a recession hits in 2023 which prolongs the bear market. The longest bear market on record was in the 1930s that lasted for 1,389 days. That was during a long-term economic downtrend so you see that it would be helpful to know if we are back in the 1930s, 1970s (bad) or 1980s, 1990s (good).

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