Philequity Corner (July 25, 2022)
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Market bottom?

The US stock market has been resilient after making a recent low on June 16. Since then, the S&P 500 has rallied 8% while the Dow and Nasdaq have gone up by 6.7% and 11.2%. Does this strong rebound connote that the market has already reached a bottom?

3666

The S&P 500 closed at a low of 3,666 on June 16, down 23.6% from its peak. We find it uncanny that the market found its low at this level. The numbers are strikingly similar to the generational bottom of the 2008-2009 bear market when the intraday low of 666 was reached on March 6, 2009 (see *666*, March 23, 2009 and *666 on 3-6-9*, April 13, 2009).

Lessons from 2009 bear market

In our book *Opportunity of a Lifetime*, we devoted a chapter to explain bear markets and describe the opportunities that they presented (see Chapter 2: Opportunity of a Lifetime). Below, we reiterate some of the lessons from our book that can help us navigate the current bear market.

1. **Bear watching.** Instead of feeling despondent, investors can capitalize on the opportunities presented by the downturn by watching how this bear market evolves. Whether or not 3,666 was indeed the bottom, buying at these levels offer major upside to investors with a long-term horizon.
2. **Bottoms take time to happen.** Calling the bottom is typically difficult as many factors can affect stock market outcomes. Patience is also required as bottoming-out takes time while the process can be volatile and tricky.
3. **Don't fight the tape.** Despite the prevailing negative sentiment, focus on what the tape is telling us. The price action of asset classes, the move of leading sectors, and various technical indicators signal that the market may be bottoming and a turn may be imminent.

Origins of the last bear markets

It is important to analyze the causes of a bear market in order to understand it and profit from it. The 2008-2009 bear market was caused by the 2008 US subprime mortgage crisis. The rapid global market selloff in 2020 was triggered by the health scare and fears brought about by the COVID-19 pandemic. Meanwhile, the 2022 bear market was driven by elevated inflation and exacerbated by Russia's invasion of Ukraine. In response to this, global central banks accelerated their monetary tightening and caused markets to drop. Investors are now concerned of a potential recession that may be triggered by tighter financial conditions.

Signs of a market bottom

Though the risks to the stock market are still in play, we believe that there are emerging signals that the market has carved a bottom on June 16. It is important to look at these signs because the stock market is always forward-looking and is typically six to nine months ahead of the economy.

1. **Peak inflation.** There are signs that inflation may have already peaked or will peak in the next few months given the precipitous drop of many commodities from their recent highs. Oil fell more than 20% from its recent peak. Copper, nickel, aluminum, lumber, wheat, corn, and soybean are all down significantly.
2. **Interest rate hikes may slow down or pause.** A peak in inflation may prompt central banks to temper or pause their policy rate hikes, and this may support a potential economic rebound.
3. **Dollar strength may pause.** The US dollar index (DXY) has pulled back 1.9% from its recent high. After breaking parity, the euro is now back to 1.02. The yen has bounced 2% from its low. A pause in dollar strength would benefit most countries and financial markets.
4. **Extreme pessimism and risk aversion.** Bank of America's latest Global Fund Manager Survey showed that market sentiment has been excessively bearish, comparable to levels last seen during the 2008-2009 bear market. Meanwhile, equity allocation vs. cash was also at the lowest level since 2008. History has shown that extreme pessimism typically marks an important market low.
5. **Improving technical picture.** The market has been on a steady short-term uptrend after rebounding from its latest trough. The S&P 500, Dow, Nasdaq, and Russell are all trading above their 50-day moving averages for the first time in three months.
6. **Market breadth improved.** The percentage of stocks trading above their 200-day moving averages hit an intraday low of 12.5% two weeks ago, indicating extreme oversold conditions. Studies show that market bottoms are usually formed at the 15% level. Market breadth has steadily improved in the past week, with the percentage of stocks trading above their 200-day moving averages climbing to 20%.

Bear market rally?

Many strategists say that the rebound since June 16 is just a bear market rally. The bears fear that a recession is forthcoming due to faster monetary tightening. They warn that rising interest rates and depreciating currencies may cause corporate balance sheets to deteriorate. Meanwhile, an overly strong US dollar would be detrimental to many vulnerable countries. The bears point out that the ill effects of the Russian invasion continue. All these may result in a spate of earnings downgrades which may bring the market to new lows.

Bull vs. bear

Investors are probably looking at 3,666 with added significance due to its resemblance to the 2009 bear market bottom of 666. On the one hand, the bulls believe that the market has made a crucial bottom on June 16. On the other hand, the bears see further downside because they believe that a recession is imminent. Whether the bulls or the bears win, we strongly believe that it is important to watch the market closely during these times. Our experiences in 2009 have taught us that bear markets provide huge upside opportunities for long-term investors.

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