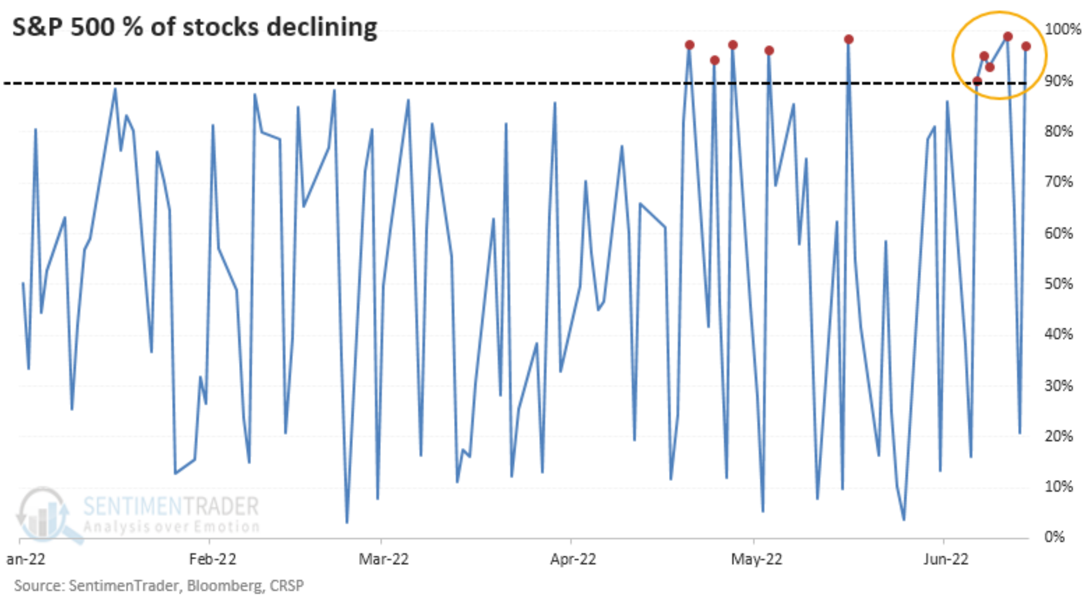
06.21.2022 – No Hope for the Bulls

Am reading the Hemingway classic book "Death in the Afternoon," which is different than I expected, at least so far. For the first 75 pages, the book is a detailed description of bullfighting and all that goes with it. I thought it would be an epic novel about people involved in bullfighting and not sort of a travelogue of bullfighting. Anyway, the usual fate of the bull is what I felt like at the end of last week.



During the previous 7 days ending June 16th, the stock markets experienced an epic bought of selling that has never been seen before, even including 1929, 2000-2002, and 2008-2009. ^ We had 5 out of 7 days where over 90% of all S&P 500 Index stocks declined in value (see red dots on graph). Even our energy holdings, which had been a stalwart and had kept our accounts afloat while everything else was cratering, saw losses of -17% during that span.* I expected some selling but was not prepared for our energy holdings to decline as they did. And, as has been par for the course, bonds were not a great help until the last couple days of the stock declines.

^Source: Sentiment Trader 06.17.2022

*Source: Yahoo Finance

Signals (8)	1 Week	2 Weeks	1 Month	2 Months	3 Months	6 Months	1 Year
1929-11-13	20.4	18.5	20.8	21.7	31.7	37.5	-6.7
1938-03-23	-12.6	-6.0	6.0	0.3	8.8	21.3	20.0
1939-08-23	4.3	14.8	18.6	19.6	14.7	11.5	-6.1
2008-10-07	0.2	-4.1	-4.4	-12.1	-9.0	-17.2	6.2
2008-11-20	19.1	16.4	15.8	10.6	2.8	21.0	45.0
2011-08-10	6.5	5.1	3.0	6.6	13.8	20.6	25.2
2011-11-23	7.1	6.2	8.9	13.5	17.7	13.4	20.4
2020-03-03	-4.0	-15.8	-17.7	-5.7	2.6	16.5	27.2
2022-06-13							
Median	**5.4**	**5.7**	**7.4**	**8.6**	**11.3**	**18.6**	**20.2**
% Positive	**75%**	**63%**	**75%**	**75%**	**88%**	**88%**	**75%**

More and more pundits are clanging the bells that we are or are soon going to be in a recession, and they may be right. For now, after this much selling, I suspect we are going to get a pretty good rally. The graph shows the data behind that assertion. After 8 other similar short-term selling periods, you can see that 3 and 6 months later, 7 of the 8 times had either solid or huge rallies. Of course (and there is always an "of course"), there were lots of ups and downs to get to those numbers.

S&P 500: Worst Performance through 113 Trading Days (1928 - 2022)

Rank	Year	Price Return: First 113 Trading Days	Price Return: Day 114 to Year-End	Price Return: Full Year
1	1932	-39.2%	40.1%	-14.8%
2	2022	-21.6%	?	?
3	1962	-21.3%	12.0%	-11.8%
4	1940	-20.6%	7.0%	-15.1%
5	1970	-19.1%	23.7%	0.0%
6	1939	-12.3%	8.1%	-5.2%
7	2002	-12.1%	-12.9%	-23.4%
8	1949	-10.9%	23.9%	10.5%
9	1937	-10.7%	-31.2%	-38.6%
10	1931	-10.4%	-40.9%	-47.1%
11	1953	-10.4%	4.2%	-6.6%
12	1982	-10.3%	27.6%	14.5%
13	1938	-9.8%	38.0%	24.5%
14	1973	-8.9%	-9.3%	-17.4%
15	2008	-8.8%	-33.5%	-39.3%

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Anytime there is a massive misallocation of capital, as we have seen the last 10 years and the last 2 especially, it has historically lead to recession. My favorite economists, the Austrians, put money (particularly in the form of credit) at the center of their analysis, and argue that artificially cheap money (artificially low interest rates) causes capital to flow to investments that would be unprofitable in unmanipulated economic conditions — and a recession is what happens when those “malinvestments” are unwound when the manipulation becomes too expensive and the underlying economic reality asserts itself.

This is what we’ve seen as hugely unprofitable businesses such as Netflix, Zoom, Uber, Peloton, and others saw valuations soar into the multi tens and hundreds of billions despite never making a dime, all on the hopes of massive profits somewhere in the distant future. Stockholders and bondholders of those companies helped to fund a lifestyle that was not sustainable and people are now finding that out. Those companies, and others that were profitable but with very high price to earnings ratios, are now forced to make profits that are reasonable for their valuations rather than just attracting new capital to continue operations.

For what it’s worth, the table shows the worst starts to the year for the S&P 500 Index since 1928. This year ranks #2 all time. The other 5 out of the top 6 worst starts were all up significantly from that point (I don’t know if they went down further before eventually having nice gains). Something to keep in mind is the big recession years of 1931, 1937, 1973, 2002, and 2008 didn’t follow that pattern and were down even more the balance of the year. This is my fear and I’m quite mindful of this (although if one goes to Costco I don’t see any letup in shopping). If EPS (earnings per share) start to contract significantly (10-15%) meaning we are in a recession, we could easily see another 15-20% decline in the major indexes.

We have been conservative at Nationwide Advisory Services and will watch trendlines closely. Until markets move above the trend lines, and I see solid evidence of a bottom over a period of time, we will remain that way.
Thanks for allowing us to be of service to you. Please let us know if you need anything.

Regards,

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