June 2022 Market Commentary

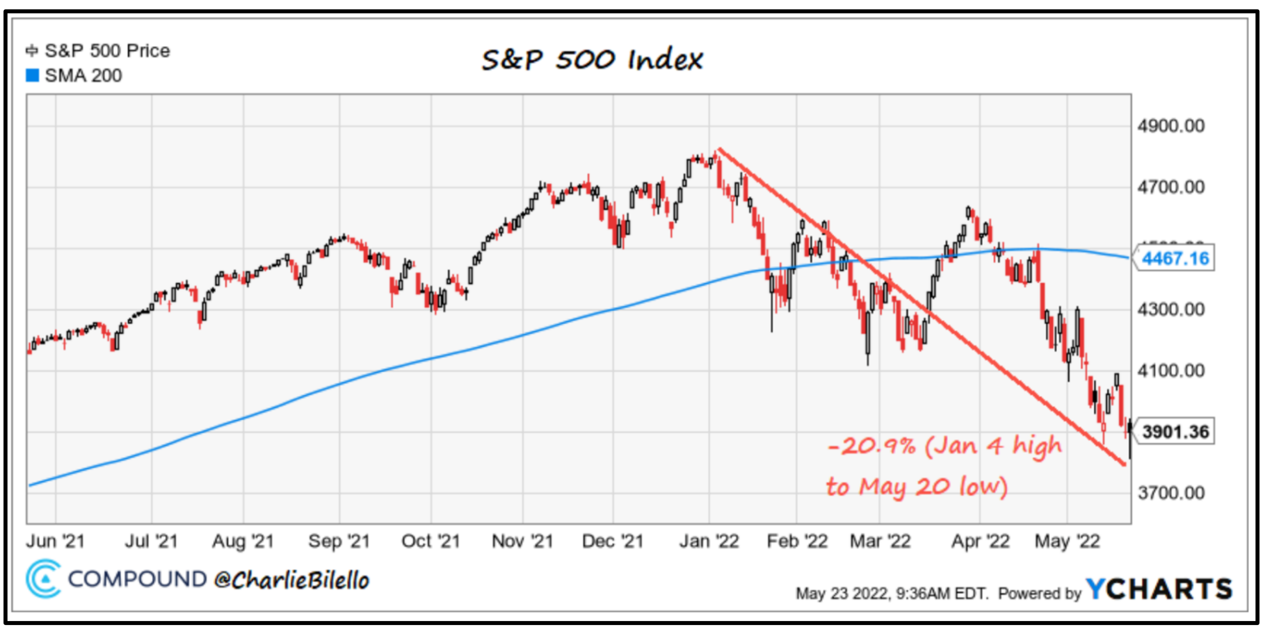
Long Time
It's been such a long time
I think I should be goin', yeah
And time doesn't wait for me
It keeps on rollin'

[***https://www.youtube.com/watch?v=ryB11nsh5BU***](https://www.youtube.com/watch?v=ryB11nsh5BU)

Until last weeks wonderfully refreshing 6.58% rally in the S&P 500, it was certainly feeling like it had ***been such a long time*** since we had an up week in the market. In fact, the week ending May 20 was the seventh consecutive down week in the market. How rare is that? Since 1928 the S&P 500 has only had three other periods where it was down seven or more weeks in a row; 1970 and 2001 eight weeks, and 1980 seven weeks.

S&P 500: Longest Consecutive Down Weeks (1928 - 2022)									
Down Week Data			S&P 500 Forward Total Returns						
End Week	Streak % Decline	Streak	3-Month	6-Month	9-Month	1-Year	3-Year	5-Year	10-Year
5/22/1970	-14.5%	8	10%	16%	34%	40%	44%	25%	47%
3/23/2001	-14.9%	8	8%	-15%	1%	2%	2%	25%	38%
3/28/1980	-12.9%	7	17%	29%	41%	41%	78%	128%	421%
5/20/2022	-14.0%	7							
8/7/1931	-10.6%	6	-18%	-43%	-55%	-50%	-35%	16%	-24%
9/20/1946	-15.2%	6	6%	4%	3%	3%	7%	61%	225%
8/23/1957	-6.6%	6	-8%	-8%	-1%	7%	28%	33%	114%
1/10/1969	-4.0%	6	1%	-5%	-7%	-8%	3%	-2%	-5%
2/11/1977	-5.2%	6	-1%	-2%	-4%	-10%	18%	30%	279%
2/17/1984	-7.3%	6	1%	8%	9%	22%	103%	127%	327%
8/24/1990	-10.4%	6	2%	20%	24%	31%	61%	108%	495%
10/13/2000	-7.3%	6	-4%	-13%	-11%	-20%	-21%	-6%	1%
10/4/2002	-11.9%	6	14%	11%	25%	31%	62%	109%	123%
7/23/2004	-2.9%	6	1%	8%	7%	16%	49%	-4%	123%
7/11/2008	-9.6%	6	-27%	-27%	-29%	-27%	16%	47%	172%
6/10/2011	-4.4%	6	-9%	0%	10%	7%	64%	84%	305%
		Average	-0.5%	-1.2%	3.1%	5.6%	31.8%	52.1%	176.1%

During that seven week stretch we also entered an official Bear Market with the S&P down 20.9% on May 20th. The big question now is the bear market near it's bottom and ready to turn up, or is it just starting?



The explosive 6.6% relief rally in the week ending May 27 may signal to some that the worst of the bear market is behind us, I'm not so sure. According to the table below, most big 6%+ weeks have led to further advances 6 and 12 months into the future, but not all.

Big Weekly Gains Tend To Mark The Start To More Strength

>6.0% Weekly Gains For The S&P 500 Index (1950 - Current)

		S&P 500 Index Returns After Six Week		
Date	Weekly Gain	3 Months	6 Months	12 Months
6/7/1974	6.0%	-22.8%	-28.5%	-0.1%
9/20/1974	7.6%	-3.6%	18.9%	22.4%
10/11/1974	14.1%	1.6%	20.3%	24.0%
11/14/1980	6.2%	-6.8%	-3.4%	-11.3%
8/20/1982	8.8%	22.4%	30.5%	44.7%
10/8/1982	7.4%	10.8%	16.6%	29.9%
11/5/1982	6.3%	2.8%	16.8%	15.0%
8/3/1984	7.4%	3.2%	10.0%	17.9%
5/2/1997	6.2%	16.5%	11.2%	38.0%
10/16/1998	7.3%	18.5%	23.6%	18.7%
6/2/2000	7.2%	2.7%	-11.0%	-14.2%
9/28/2001	7.8%	11.5%	9.2%	-21.7%
3/21/2003	7.5%	11.2%	15.7%	22.3%
10/31/2008	10.5%	-13.4%	-6.7%	7.7%
11/28/2008	12.0%	-22.3%	5.4%	22.2%
1/2/2009	6.8%	-9.6%	-3.6%	21.6%
3/13/2009	10.7%	25.1%	37.8%	52.1%
3/27/2009	6.2%	12.6%	28.0%	43.8%
7/17/2009	7.0%	16.6%	20.8%	13.9%
12/2/2011	7.4%	8.0%	3.3%	13.3%
3/27/2020	10.3%	18.4%	30.5%	56.3%
4/9/2020	12.1%	14.2%	22.2%	48.0%
11/6/2020	7.3%	11.4%	19.7%	34.0%
3/18/2022	6.2%	?	?	?
5/27/2022	6.6%	?	?	?
Average		5.6%	12.5%	21.7%
Median		10.8%	16.6%	22.2%
Higher		17	18	19
Count		23	23	23
% Higher		73.9%	78.3%	82.6%

Source: LPL Research, FactSet 05/27/2022

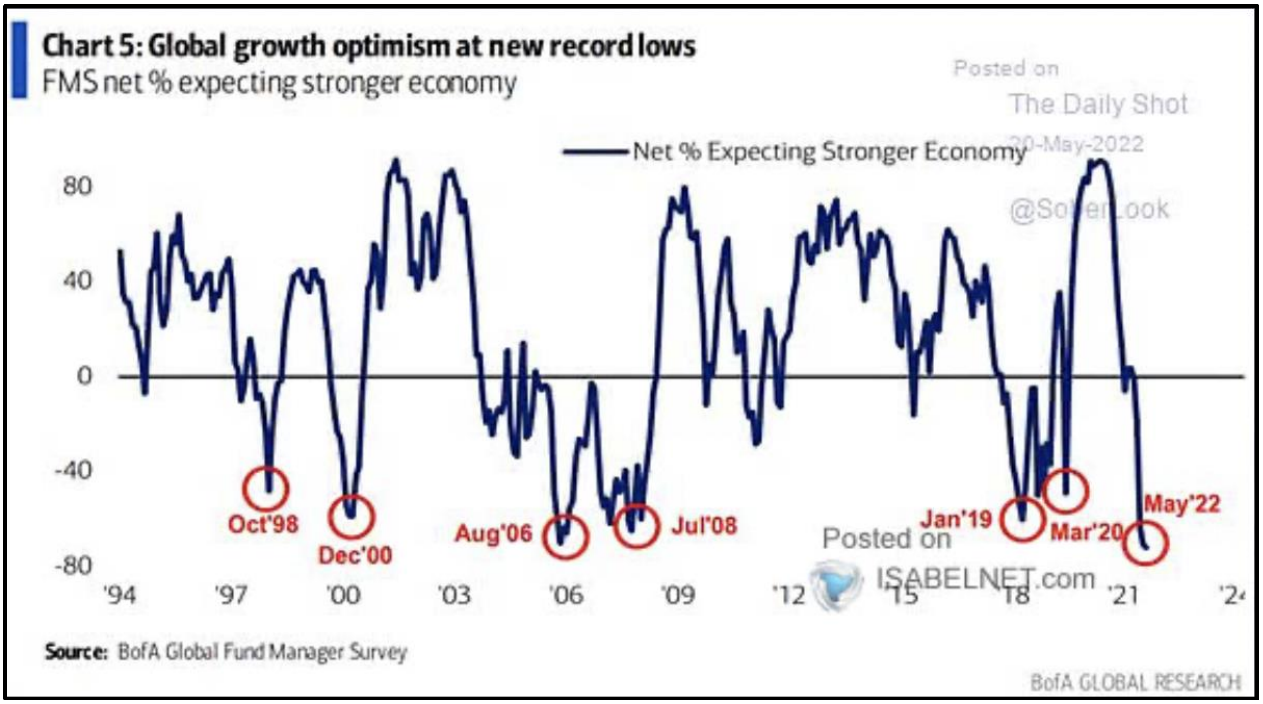
All indexes are unmanaged and cannot be invested into directly. Past performance is no guarantee of future results.

Performance back to 1950 incorporates the performance of predecessor index, the S&P 90.

All bear markets are not the same so it is extremely dangerous to extrapolate averages when looking at them. In four of our most recent 20% down bear markets (1990, 1998, 2011, and 2018) we had rather fast recoveries because the Federal Reserve stepped in and eased monetary policy. This became known as the “Fed Put”. It also happened in 2008-2009, and 2020 but the declines were more severe before the Fed Put could change investor psychology.

Generally, for a bear market to end you need three conditions to take place; 1) Investor psychology is very negative, 2) Investors can start to see their way through the challenges, and 3) Monetary policies are helpful, in other words the Fed Put is brought to life.

Unfortunately, we only seem to be close to having the first condition currently in place, investors are scared. On numerous fronts optimism seems to be near record lows, and generally that has been a good contrary indicator that now is probably a good time to start putting money to work. But again, this is only one leg of the three-legged stool.



My concern is that this time is more like the bear market of 1973-1974. Just as then, the primary concern of the country is inflation, thanks to a war related oil-price shock. Just as then the inflationary shock took hold when the Fed had rates much too low and was forced to raise rates rapidly. Also, back then we had a group of highly valued speculative stocks, the Nifty Fifty, which are similar to our FANGS, that had soared in prior years.

In 1974 the Fed kept raising rates even as a recession took hold because they were running to catch up and quash inflation. The result was a brutal 48% decline in the S&P 500 over 21 months, interspersed with joyful soul-destroying rallies, two of 10%, two of 8%, and two of 7%, each snuffed out.

I'm not saying that today is going to be a repeat of the '70's, so far, we're not yet in a recession, but let's take a look at those other two legs of the stool.

Again, <u>Leg #1</u> – Negative Investor Sentiment seems to be mostly in place, though it can stay negative for some time.

<u>Leg #2</u> – Investors seeing their way through the challenges, still seems non-existent. If our biggest challenge is inflation, it is hard to see anything very positive on that front. Yes, the rate

of increase may have peaked, but the absolute price levels are still heading upward. As is often said, the best remedy for high prices is high prices. Eventually high prices destroy demand.

Energy inflation is our biggest near-term problem, and unfortunately, we have an administration that is still totally against doing anything that would help energy companies produce, refine or transport more energy. They have killed any incentive companies may have to invest for the long-term energy independence of America, and openly gloat about their goal of taxing them out of existence.

Another sign that the current administration doesn't understand our inflationary problem, let alone know how to fix it, is the economic ignorance of cancelling $10,000 of student debt. This type of monetary game totally ignores the inflationary impact of all the free money that was doled out during the pandemic as businesses were forced to close. The idea is profoundly misguided for numerous reasons, not the least of which are the inflationary consequences. At a time when the country should be battening down the hatches, the Biden administration is going to hand-pick a select few Americans to receive $10,000 worth of benefits – **paid for by other Americans** – with the only qualifier being that they don't understand math and took on more debt that their education is worth.

Leg #3 – The Fed rides to the rescue and begins easing monetary policy. This is not going to happen for some time.

It is pretty clear that the Fed had kept rates at zero for much too long and is now in a long-term chase to try and catch-up. Even former Fed Chair and current Treasury Secretary Janet Yellen admitted that she was wrong on the path that inflation would take. The Fed's mandate is full employment and price stability (i.e., low inflation), so with unemployment very low they will continue to raise rates until something breaks. Specifically, they will raise rates until the economy slows, thereby slowing inflation, and hopefully not lead to a recession and too much unemployment.

In summary, we have one wobbly leg of a three-legged stool in place (investors are fearful), so I have a very hard time saying that this bear market is close to being over. Sure, valuations have improved. The Price-to-Earnings (P/E) ratio of the S&P 500 has fallen from about 23x to 17.5x but that doesn't mean stocks are cheap.

As the table below shows with the S&P 500 at 4,158 and a current earnings forecast of $236.79 the P/E is 17.5x. If the Fed is successful in slowing the economy it is probably fair to expect earnings estimates to decline some, maybe $230 or $220. If the reason the Fed is successful is because they have raised rates enough to slow the economy, then it is also probably fair to expect the multiple investors are willing to pay for those earnings to decline to maybe 15 or 16 times. If that's the case we probably have another 10%-20% downside.

S&P 500 Estimated Return Scenarios

		Estimated Forward Earnings S&P 500								
		$ 200	$ 210	$ 220	$ 230	$ 236	$ 240	$ 250	$ 260	$ 270
	13	-37.47%	-34.35%	-31.22%	-28.09%	-26.22%	-24.97%	-21.84%	-18.72%	-15.59%
	14	-32.66%	-29.30%	-25.93%	-22.56%	-20.54%	-19.20%	-15.83%	-12.46%	-9.10%
	15	-27.85%	-24.25%	-20.64%	-17.03%	-14.87%	-13.42%	-9.82%	-6.21%	-2.60%
	16	-23.04%	-19.20%	-15.35%	-11.50%	-9.19%	-7.65%	-3.81%	0.04%	3.89%
Estimated	17	-18.23%	-14.15%	-10.06%	-5.97%	-3.52%	-1.88%	2.21%	6.29%	10.38%
P/E Ratio	17.5	-15.83%	-11.62%	-7.41%	-3.20%	0.00%	1.00%	5.21%	9.42%	13.63%
	18	-13.42%	-9.10%	-4.77%	-0.44%	2.16%	3.89%	8.22%	12.55%	16.88%
	19	-8.62%	-4.05%	0.52%	5.09%	7.83%	9.66%	14.23%	18.80%	23.37%
	20	-3.81%	1.00%	5.81%	10.62%	13.51%	15.43%	20.24%	25.05%	29.86%
	21	1.00%	6.05%	11.10%	16.15%	19.19%	21.21%	26.26%	31.31%	36.36%
	22	5.81%	11.10%	16.40%	21.69%	24.86%	26.98%	32.27%	37.56%	42.85%
	23	10.62%	16.15%	21.69%	27.22%	30.54%	32.75%	38.28%	43.81%	49.34%

Current (5/27/22) S&P 500 Price $4,158.24
Current 12-month Forward Earnings Estimate $236.79
Current S&P 500 P/E 17.56x

I’m trying to stay hopeful that the economy is resilient enough not to fall into a deep recession, but I’m also trying to be realistic enough to know that this doesn’t have the makings of a quick dip bear market. It looks and feels like something that will last a long time. Fortunately, (because we’re old) our investment team here at Medallion has seen and survived the many bear markets, they’re still painful but we’re ready to walk you through this one.

And time doesn't wait for me
It keeps on rollin'
There's a long road, I've gotta stay in time with, yeah
I've got to keep on chasin' that dream
Though I may never find it
I'm always just behind it

As always, be careful out there.

Chris Wiles, CFA

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