# A New Bull Market -or- A Textbook Bear Market Rally?

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For a great many investors, the question of the day is if the recent rebound in stocks represents the beginning of a new bull market or a run-of-the-mill bear market rally.

Decades of experience in the stock market game have taught us that it is impossible to know the answer to this question without a healthy dose of hindsight. As such, we believe the best approach to these situations is to (a) look at both sides of the argument, (b) develop a plan based on the outlook, and (c) remain flexible, nimble, and open-minded.

**Quick Take: Technicals Favor Bulls, Macro Favors Bears**

Let's start with the bull case. The premise is the 17.2% rebound from the June 22nd low represents the beginning of a new bull market. This is encouraging because since 1900, bull markets have seen average gains of between +85% and +105% (according to Ned Davis Research Group, the mean return for cyclical bull markets occurring within a secular bull cycle has been 105.3% over 751 days while the mean for all bull markets since 1900 has been 85.9% over 576 trading days).

The primary arguments for the new bull market case are technical in nature as the recent price action has been very constructive. For example, several "breadth thrust" buy signals have occurred, the major indices have put in "higher highs" (the basic component of an uptrend) both on a short- and intermediate-term basis, the rally has been broad-based with small- and mid-caps participating, and history shows once the S&P 500 recovers 50% of a bear market's decline, the indices have rarely, if ever broken to new lows.

**Trust the Thrust**

Breadth thrust signals are momentum indicators designed to tell us when buying/selling pressures become overwhelmingly one-sided. History shows that when buyers dominate sellers over a meaningful period, stocks tend to outperform over the ensuing 1-, 3-, 6-, and 12-months.

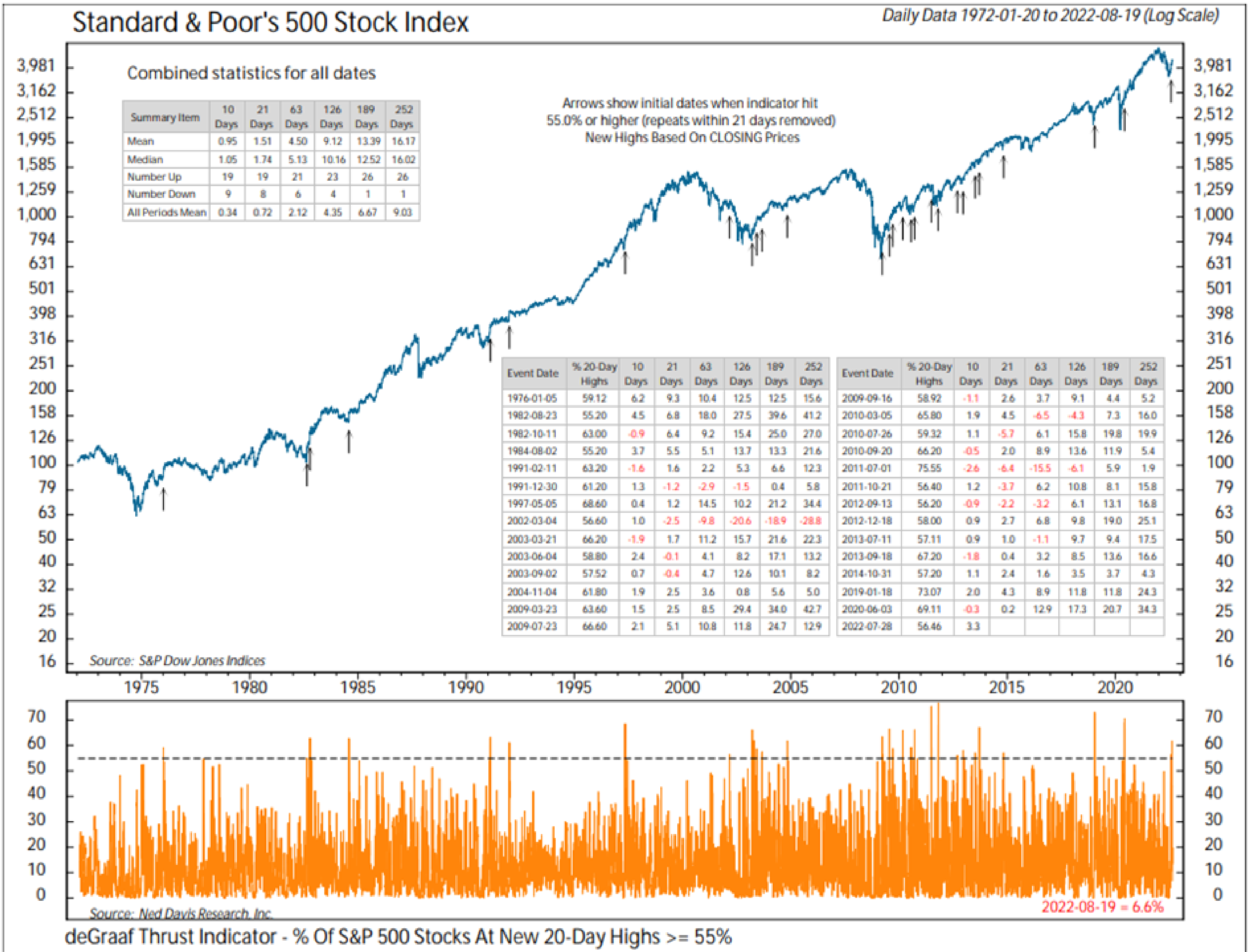
The original Breadth Thrust indicator, which measured the average of advances versus declines over a 10-day period, was developed by the late Marty Zweig. And as Ned Davis is famous for saying, it pays to "trust the thrust." For good reason. History shows that when a breadth thrust signal occurs, it tends to be an "all clear" signal for the coming year.

We utilize a Breadth Thrust Model in our work. The model is comprised of five separate breadth thrust indicators. Looking at each component indicator's signals from a hypothetical standpoint, history shows that one month after a buy signal is given, the S&P 500 has been higher 74% of the time. Three months after the signal, the market has been higher 77.1% of the time. Six months after: 86.1%. And one year out, the market has been higher 97.2% of the time.

Another way to look at the hypothetical history is that of the 144 signals the five component indicators in the model have flashed, only four have been losers one year after the signal was given.

For the record, our Breadth Thrust model flashed a buy signal on July 28, 2022.

Below is a chart illustrating one of the component indicators of the Breadth Thrust Model, courtesy of Ned Davis Research Group. As you can see from the chart, buy signals have generally led to strong upside in the ensuing months.




| Summary Item | 10 Days | 21 Days | 63 Days | 126 Days | 189 Days | 252 Days |
|---|---|---|---|---|---|---|
| Mean | 0.95 | 1.51 | 4.50 | 9.12 | 13.39 | 16.17 |
| Median | 1.05 | 1.74 | 5.13 | 10.16 | 12.52 | 16.02 |
| Number Up | 19 | 19 | 21 | 23 | 26 | 26 |
| Number Down | 9 | 8 | 6 | 4 | 1 | 1 |
| All Periods Mean | 0.34 | 0.72 | 2.12 | 4.35 | 6.67 | 9.03 |

| Event Date | % 20-Day Highs | 10 Days | 21 Days | 63 Days | 126 Days | 189 Days | 252 Days |
|---|---|---|---|---|---|---|---|
| 1976-01-05 | 59.12 | 6.2 | 9.3 | 10.4 | 12.5 | 12.5 | 15.6 |
| 1982-08-23 | 55.20 | 4.5 | 6.8 | 18.0 | 27.5 | 39.6 | 41.2 |
| 1982-10-11 | 63.00 | -0.9 | 6.4 | 9.2 | 15.4 | 25.0 | 27.0 |
| 1984-08-02 | 55.20 | 3.7 | 5.5 | 5.1 | 13.7 | 13.3 | 21.6 |
| 1991-02-11 | 63.20 | -1.6 | 1.6 | 2.2 | 5.3 | 6.6 | 12.3 |
| 1991-12-30 | 61.20 | 1.3 | -1.2 | -2.9 | -1.5 | 0.4 | 5.8 |
| 1997-05-05 | 68.60 | 0.4 | 1.2 | 14.5 | 10.2 | 21.2 | 34.4 |
| 2002-03-04 | 56.60 | 1.0 | -2.5 | -9.8 | -20.6 | -18.9 | -28.8 |
| 2003-03-21 | 66.20 | -1.9 | 1.7 | 11.2 | 15.7 | 21.6 | 22.3 |
| 2003-06-04 | 58.80 | 2.4 | -0.1 | 4.1 | 8.2 | 17.1 | 13.2 |
| 2003-09-02 | 57.52 | 0.7 | -0.4 | 4.7 | 12.6 | 10.1 | 8.2 |
| 2004-11-04 | 61.80 | 1.9 | 2.5 | 3.6 | 0.8 | 5.6 | 5.0 |
| 2009-03-23 | 63.60 | 1.5 | 2.5 | 8.5 | 29.4 | 34.0 | 42.7 |
| 2009-07-23 | 66.60 | 2.1 | 5.1 | 10.8 | 11.8 | 24.7 | 12.9 |

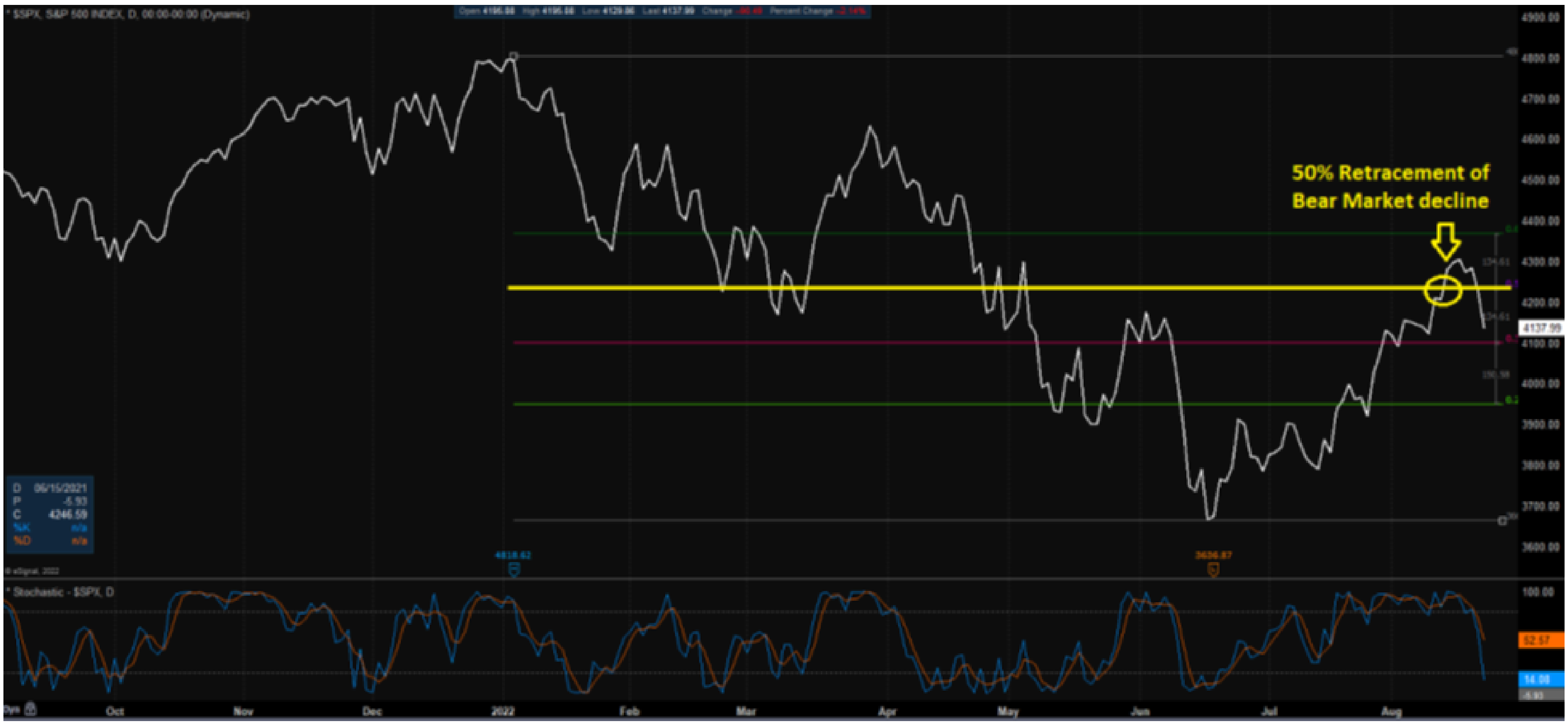
| Event Date | % 20-Day Highs | 10 Days | 21 Days | 63 Days | 126 Days | 189 Days | 252 Days |
|---|---|---|---|---|---|---|---|
| 2009-09-16 | 58.92 | -1.1 | 2.6 | 3.7 | 9.1 | 4.4 | 5.2 |
| 2010-03-05 | 65.80 | 1.9 | 4.5 | -6.5 | -4.3 | 7.3 | 16.0 |
| 2010-07-26 | 59.32 | 1.1 | -5.7 | 6.1 | 15.8 | 19.8 | 19.9 |
| 2010-09-20 | 66.20 | -0.5 | 2.0 | 8.9 | 13.6 | 11.9 | 5.4 |
| 2011-07-01 | 75.55 | -2.6 | -6.4 | -15.5 | -6.1 | 5.9 | 1.9 |
| 2011-10-21 | 56.40 | 1.2 | -3.7 | 6.2 | 10.8 | 8.1 | 15.8 |
| 2012-09-13 | 56.20 | -0.9 | -2.2 | -3.2 | 6.1 | 13.1 | 16.8 |
| 2012-12-18 | 58.00 | 0.9 | 2.7 | 6.8 | 9.8 | 19.0 | 25.1 |
| 2013-07-11 | 57.11 | 0.9 | 1.0 | -1.1 | 9.7 | 9.4 | 17.5 |
| 2013-09-18 | 67.20 | -1.8 | 0.4 | 3.2 | 8.5 | 13.6 | 16.6 |
| 2014-10-31 | 57.20 | 1.1 | 2.4 | 1.6 | 3.5 | 3.7 | 4.3 |
| 2019-01-18 | 73.07 | 2.0 | 4.3 | 8.9 | 11.8 | 11.8 | 24.3 |
| 2020-06-03 | 69.11 | -0.3 | 0.2 | 12.9 | 17.3 | 20.7 | 34.3 |
| 2022-07-28 | 56.46 | 3.3 | | | | | |

## The Trend is Your Friend

Next, market technicians contend the major indices are now in an uptrend. Uptrends occur when a security traces out a stair-step pattern of higher highs and higher lows on the chart. Thus, once the S&P moved above the June 3rd closing high, a "higher high" and, in turn, an uptrend was in place.


## Fibonacci Retracement History is Encouraging

In addition, we should consider the history of what happens after the market "retraces" at least 50% of a bear market decline. According to BTIG's Chief Market Technician, Jonathan Krinsky, the S&P 500 recovered 50% of the bear market's decline once it advanced past 4231. This is important because, according to Krinsky, since 1950 the market has never made a new low after a 25% decline was followed by a 50% retracement.

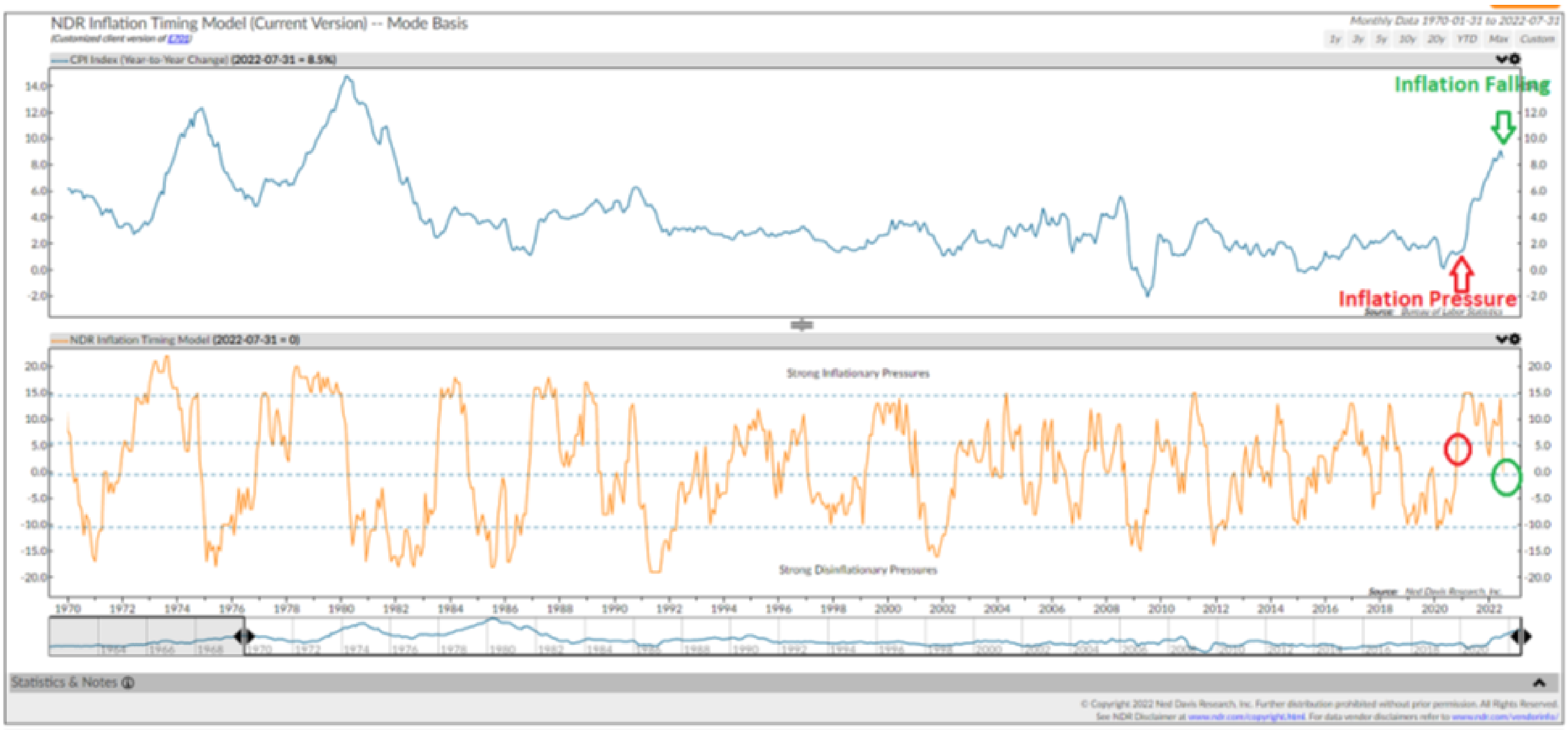


However, it is also important to note that three healthy drawdowns during the period studied after the S&P recovered half the loss: 1974, 2014, and December 2009. But the key is that the market has never made a new low after the 50% retrace. As such, Krinsky (and others) use this to contend that the low for this bear market is in.

**Three "Peak" Narratives**

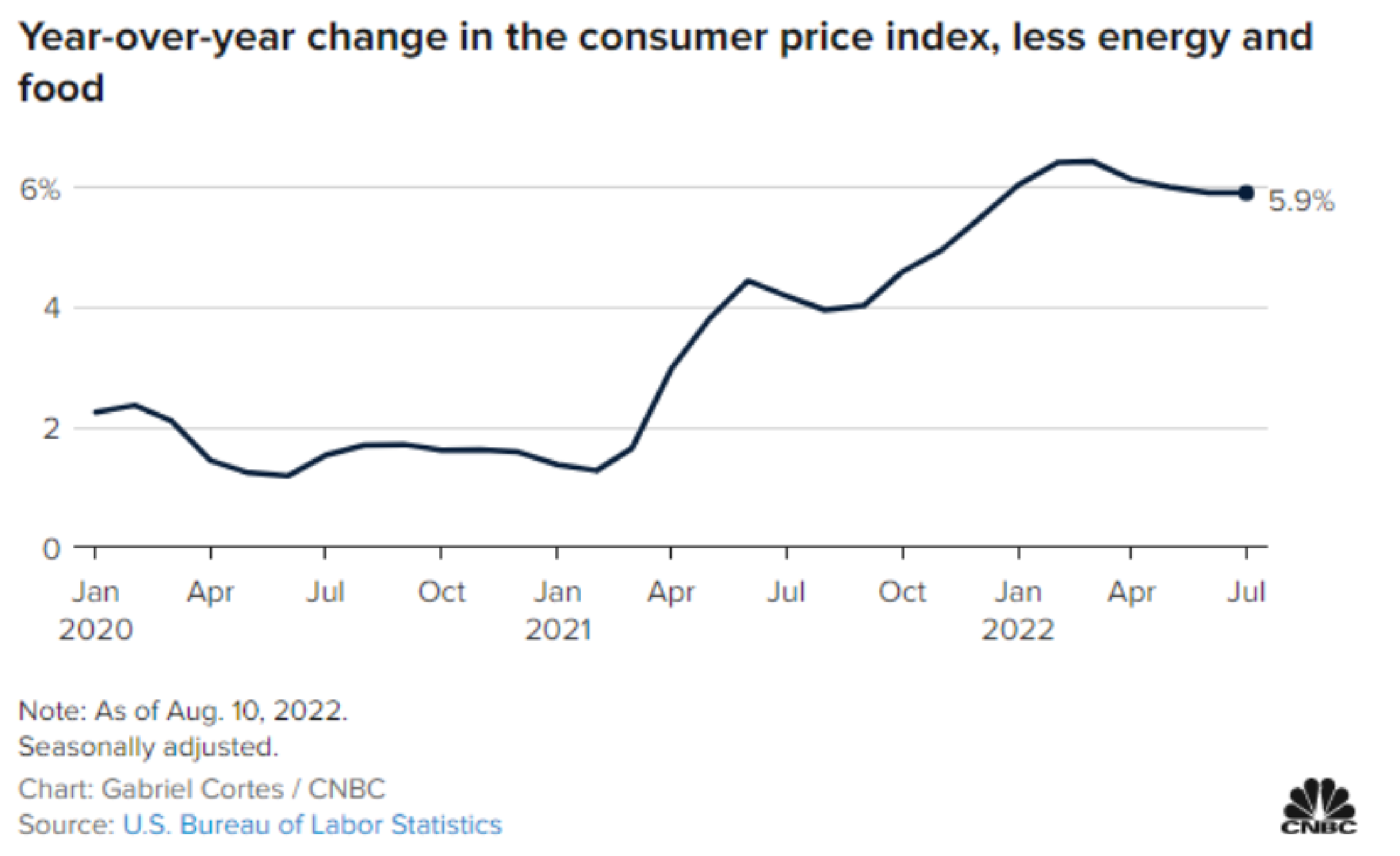
In addition to the positive technical action, the bulls point to several "peak" narratives as reasons to hop aboard the bull train. First, there is the "peak inflation" theme, which argues that inflation has peaked and will trend lower in the months ahead.

Our indicators and models on inflation support this concept as many components of inflation are indeed declining. For example, our Inflation model has slipped into the neutral zone (albeit by the skinniest of margins) which suggest that inflation pressures are likely to decline in the coming months. It is worth noting that this model did a fine job warning of increasing inflationary pressures – back in the fall of 2020, which was well BEFORE inflation became a problem.




Next is the "peak Fed hawkishness" theme. If inflation can begin to trend lower, the thinking is that the Fed will be able to back away from their aggressive rate hiking path at some point in the future. And given that markets look ahead 6-9 months, it makes sense that a less antagonistic Fed could be a positive.

And finally, there is the "peak volatility" theme, which argues that we may have seen the worst of the market's nasty volatility. Analysts point to the downward trend in the VIX as Exhibit A here. Of course, time will tell if this trend can continue and if volatility will remain muted. But, if inflation can begin to recede and the economy remains no worse for wear, then it follows that the worst of the violent down days may be behind us.




Next up is the issue of the "Fed pivot" – the point in time where the Fed can change their stance and stop aggressively raising rates. Currently, it appears that the Fed is "not even thinking about thinking about" cutting rates as FOMC members have made it clear that fighting inflation is Job 1 at this time.

**A Policy Mistake?**

The worry is since there is a significant lag between the time rates are increased and the ensuing impact on the economy and/or consumer behavior occurs, the Fed may not be able to avoid a recession.
In other words, bears contend that the Fed will go too far and push the economy into recession in the process. And given the rather significant deterioration seen in many economic reports of late, this is likely to be a primary focal point of markets going forward.

**The History of Bear Market Rallies**

Next up is the history of bear market rallies to consider. BofA's Michael Hartnett did a study of rallies of 10% or more during what the bank views as official bear market periods. Mr. Hartnett found that the average gain of bear market rallies was 17.2% over 39 days. He then pointed out that the current rally has produced a gain of 17.2% over 41 days. As such, BofA contends that the recent rally represents a "textbook" bear market rally, that may soon give way to more downside.

**The Plan Going Forward**

Thus far, we have presented arguments that support the ideas that (a) a new bull market has begun and (b) the recent advance was merely a bear market rally, which is likely to lead to additional downside.

However, we believe it will take time for the market to work through the issues it faces and chart a new course. As such, we would not be surprised to see a series of fits and starts (rallies and pullbacks) in the coming months as traders try to determine the most appropriate outlook for the next 2-3 quarters.

From our seat, the best plan for this environment is to (a) retain as much flexibility as possible in your investing strategy, (b) keep an open mind and avoid "planting the flag" with your opinion on the outcome, and (c) commit to being as nimble as possible when/if conditions change.

Remember, this game isn't about "being right," it's about "getting it right." And during times like these "getting it right" may involve being patient as well as maintaining the flexibility to tactically adjust to changing conditions.