Stocks Enter a Bear Market – Here's What Investors Should Do Next

U.S. stocks entered a technical bear market this week, with the S&P 500 index declining more than -20% from its January peak. The downdraft has been led by technology shares, which disproportionately impact the broad index's returns since technology is the largest sector by market capitalization. As of this writing, tech shares are down over -30% from their peak.[1]

It's also true, however, that technology shares remain over +20% higher than they were pre-pandemic, which signals the market is simply repricing some of the exorbitant gains posted in the second half of 2020 and throughout 2021. Remember, too, that U.S. stocks soared more than +100% from the Covid-19 bear market lows, which means this current retracement of -20%—while unpleasant and unwelcomed—does not make equity investors any worse off than they were two years ago. In fact, U.S. household net worth is still hovering around all-time highs, thanks in large part to +20% gains in home equity over the past year.[2]

My advice to investors now is not to get drawn into the fear narratives that always accompany sharp stock market declines. In my four-plus decade career, every bear market I've seen has been accompanied by a sense of dread that the U.S. economy now faces an existential problem that will persist for many years. This time around the problem is inflation, which many believe can only get worse. There is also a seemingly widely-held belief that the U.S. economy is already in freefall, which has driven pessimism to extremes.

Case in point: last week's University of Michigan Consumer Sentiment Survey found that Americans are more dissatisfied with the economy today than they were in the depths of the 2008 Global Financial Crisis. The unemployment rate climbed to 10% during that time and almost 10 million Americans lost their homes. Today, there are more available jobs than there are unemployed people, and discretionary spending remains relatively

strong. Spending on everything from airline tickets, to hotel stays, to restaurants has been going up, which is the type of activity you'd expect to see in good times – not dreadful ones.

We're seeing this same disconnect in the small business space, a key engine of growth for the U.S. economy. Normally, small business sentiment about the economy is tightly correlated with hiring plans – optimistic small business owners make plans to hire more workers, and vice versa. But today the opposite is true. Small businesses are reporting low levels of optimism about the economy, but at the same time, they're trying to bring on more workers.

This leads me to believe we are experiencing a recession-less, sentiment-driven bear market that is not likely to resemble the big, fundamentally-driven bear markets of 2000 and 2008. We've seen this outcome many times throughout history. There have been 26 bear markets since 1929, but only 15 of them were tied to a recession. Zacks is still estimating over 2% GDP growth for the U.S. this year.

As I have written many times before, I am not proclaiming the U.S. economy to be in perfect shape with all concerns and fears being unwarranted. I am simply highlighting that current sentiment reflects an economy that is mired in recession, when in fact jobs are plentiful, profit margins are high, and fundamental indicators like services PMI and consumer spending are signaling growth. The wider the gap between how investors and consumers feel relative to how the economy is performing, the closer I think we get to see a market low.

The table below shows how the S&P 500 has historically responded in the months and years after closing in a bear market. While we cannot know whether or for how long the bear market will continue, we do know that periods of weak returns have almost always been followed by periods of strong returns.

S&P 500 Return after 20% Drop

Bear Start Date	One Month Later	Three Month Later	Six Month Later	One Year Later
October 21, 1957	3.40%	5.49%	9.66%	30.96%
May 28, 1962	-1.96%	5.93%	11.93%	26.14%
August 29. 1966	2.39%	7.90%	16.44%	24.62%
January 29, 1970	4.69%	-4.53%	-8.93%	11.89%
November 27, 1973	2.13%	0.73%	-7.66%	-26.92%
February 22, 1982	1.06%	2.87%	4.05%	30.37%
October 19, 1987	6.76%	10.89%	14.71%	23.19%
March 12, 2001	0.28%	6.41%	-11.98%	-1.24%
July 10, 2002	-1.81%	-12.66%	0.77%	7.41%
July 9. 2008	4.87%	-26.90%	-28.47%	-29.08%
February 23, 2009	10.71%	22.47%	37.97%	47.26%
March 12, 2020	11.33%	22.60%	36.40%	58.96%
Median	2.89	5.71	6.85	23.90

Source: Zacks Investment Management

Bottom Line for Investors

As for what investors should do now, my answer is not to panic and to stick to your plan. Trying to time the bottom of a bear market is hazardous and ripe for making a serious misstep, so I strongly caution against attempting to do so. About a third of the stock market's best days have happened within the first two months of a bull market, which we will only be able to confirm with the benefit of hindsight. The biggest risk now, in my view, is being on the sidelines when that happens.

ABOUT MITCH ZACKS

Mitch is the CEO & Senior Portfolio Manager at Zacks Investment Management. Mitch has been featured in various business media including the Chicago Tribune and CNBC. He wrote a weekly column for the Chicago Sun-Times and has published two books on quantitative investment strategies. He has a B.A. in Economics from Yale University and an M.B.A in Analytic Finance from the University of Chicago.

[1] Wall Street Journal. June 14, 2022. https://www.wsj.com/articles/bull-markets-winners-dragged-the-s-p-500-into-a-bear-market-11655184522?mod=hp_lead_pos7

[2] Hartford Funds. 2022. https://www.hartfordfunds.com/practice-management/client-conversations/bear-markets.html#:~:text=Watch%20for%2020%25%3A%20Market,of%2010%25%2D19.9%25

Weekly Market Update

Important Market News We Think Worth Considering

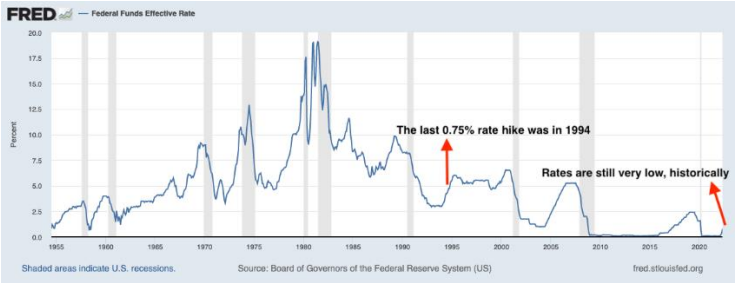
IN FOCUS THIS WEEK

- **Federal Reserve raises rates**
- **Low Fed funds rate**
- **U.S. stocks touch bear market territory**
- **Fall of retail sales**
- **U.S. home equity reaches record high**

The Federal Reserve Raises Rates by 0.75%

The much-awaited Federal Reserve rate hike decision came last Wednesday, and it proved to be on the high-end of the market's expectations. The Federal Open Market Committee voted 10-1 to hike the benchmark fed funds rate by 0.75%, an increase not seen since 1994. The sizable rate hike seems dramatic, particularly since the Fed appears to be racing to stave off further inflation. But context is also important: even with the 0.75% rate increase, the fed funds benchmark rate now sits at a range of 1.5% to 1.75%, which is still very low by historical standards (see chart below). For readers who may not be familiar with the fed funds rate, it represents an overnight rate on lending between banks. This overnight rate influences the interest rates that banks issue on loans, credit cards, savings accounts, etc. The Federal Reserve issued more guidance on the potential path of rate increases for the remainder of the year, both those projections shift often and have not been very reliable. More important is what the Fed may do at its next meeting, to which Federal Reserve Chairman Jerome Powell remarked that he does not "expect moves of this size [0.75%] to be common, adding that the late July decision "could well be about a decision between 50 and 75" basis points.[1]

The Fed Funds Rate is Still Very Low



Source: Federal Reserve Bank of St. Louis[2]

U.S. Stocks Dip into Bear Market Territory

Stocks rallied on the day of the Federal Reserve's announcement, but last week saw the S&P 500 dip into bear market territory (a decline of -20% or more). Technology shares have led the declines while Energy stocks have moved in the complete opposite direction, having posted sizable gains year-to-date. Even with technology's outsize declines, however, the S&P 500 technology sector remains over +20% higher than it traded pre-pandemic, a reminder that the drawdown follows two years (2020 and 2021) of major gains. Looking ahead, it's important to remember that trying to time the bottom of a bear market is hazardous and ripe for making a serious misstep. History tells us that pronounced volatility – in both directions – is likely to persist now that a bear market has been confirmed. In the last 20 years, about 50% of the S&P 500 Index's strongest days were posted during a bear market, and 34% of the market's best days took place in the first two months of a bull market – which can only be confirmed with the benefit of hindsight.[3]

Retail Sales Fell 0.3% in May, But the Headline Number Doesn't Tell the Whole Story

Market-watchers were spooked this week when retail sales – which measure spending at stores, restaurants, and online – dropped by 0.3% month-over-month in May. The decline marked the first-time retail sales dipped in 2022, which garnered headlines that the U.S. consumer was tapping out. But a closer read of the figures shows that a sizable drop in vehicle sales disproportionately affected the number. Excluding autos and gasoline, retail sales were positive for the month. It is also worth noting that year-over-year, retail sales have risen 8.1% from last May, which trails the 8.6% inflation rate but still signals that consumers are out spending. According to Federal Reserve Chairman Jerome Powell, "overall spending is very strong," and "we see the economy slowing a bit but still at healthy growth levels.'[4]

U.S. Home Equity Reaches Record High

In a week seemingly filled with bad news and negative headlines, there was one bright spot for homeowners in the U.S. Total home equity jumped by nearly 20% in Q1 2022, reaching a record-high $27.8 trillion. The amount of equity that homeowners can access grew by a record $1.2 trillion in Q1 to $11 trillion, and a majority of that equity is in the hands of homeowners with mortgage rates lower than 4%. From a net worth perspective, an optimistic view would be that a 20% increase in home equity over the past year neutralizes a -20% loss in the stock market, keeping household net worth near record highs.[5]

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[1] Wall Street Journal. June 15, 2022. https://www.wsj.com/articles/fed-raises-rates-by-0-75-percentage-point-largest-increase-since-1994-11655316170

[2] Fred Economic Data. June 1, 2022. https://fred.stlouisfed.org/series/FEDFUNDS

[3] Wall Street Journal. June 14, 2022. https://www.wsj.com/articles/bull-markets-winners-dragged-the-s-p-500-into-a-bear-market-11655184522?mod=hp_lead_pos7

[4] Wall Street Journal. June 15, 2022. https://www.wsj.com/articles/us-economy-retail-sales-may-2022-11655238895?mod=hp_lead_pos1

[5] Wall Street Journal. June 15, 2022. https://www.wsj.com/articles/u-s-home-equity-hits-highest-level-on-record-27-8-trillion-11655250769

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