



Mitch on the Markets

Portfolio Manager Investing Insights

WEEKLY CLIENT COMMENTARY

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Has the Bear Market Officially Ended?

Many headlines boasted last week that the Nasdaq Composite had officially entered a new bull market, which is technically true – over the course of the last several weeks, the tech-heavy Nasdaq bounced over +20% from its mid-June low, as investors poured back into some of the hardest hit shares in the first half of the year.

This sharp recovery has some pundits declaring the end of the bear market, which I think is a bit premature. Bear markets historically last about 10 months, and they are also notorious for staging rallies that investors often mistake for the start of a new bull. These are often referred to as “dead cat bounces,” and are fairly common in bear markets. In the 2000 – 2002 downturn, for example, there were four instances when the S&P 500 recovered by about 20%, only to continue making new lows until hitting a bottom in late 2002.¹

Since the 2000-2002 bear market, roughly half of the S&P 500’s best days have taken place during a bear, and about one-third of the best days happened at the very beginning of a new bull market. And anytime the market is up or down more than 3%, it is almost always during a bear market. Big moves happen in choppy

markets, and they usually occur at a time when no one truly knows whether we are actually in a bull or a bear market, which can only be determined with the benefit of hindsight. Again, I think it is too early to declare the bear market officially over.

One of the key drivers behind this recent rally appears to be the July inflation print, which showed the consumer-price index rising 8.5% year-over-year, down from 9.1% in June. The month-over-month inflation reading for July was also flat, which signaled to some market participants that inflation may have peaked.

The thinking goes that falling inflation means less pressure on the Federal Reserve to raise rates as aggressively as they have been, which would be a tailwind for markets. This outlook can be confirmed in the futures markets, which continue to show traders wagering the fed funds rate will peak by next spring, and also that the Federal Reserve will start cutting rates sometime later next year. These markets are pegging the Fed’s target rate at 3.2% by the end of 2023, which is lower than what Fed officials projected in their June minutes.

But these forecasts in the futures markets have been wrong before, and recently. This time last year, the prevailing bets in derivatives markets pegged inflation at 3.3% from summer 2021 to summer 2022, which turned out to be way off the mark. Prices rose nearly three times as fast as the forecast called for.

In my view, it is hazardous to try and guess the Fed's course of policymaking over the next 12 months, which it appears that some of the current bulls are doing. While I agree inflation pressures are likely to abate in the coming months and quarters, there is no telling if some extraneous factor – like the war in early 2022 – may come along and disrupt supply chains and commodity markets again. That's impossible to know, but it could be influential in the Fed's decision-making.

Bottom Line for Investors

Most readers and investors have seen the statistics about long-term returns in the stock market, which have been about +10% annualized over the past century. That is a highly desirable return for most people, and the upshot of investing in the stock market is that bear markets are baked into these annualized returns. Stocks lose an average of 36% in bear markets, but they gain an average of 114% in bull markets. Bull markets also last much longer, on average.

I realize it can be fairly unsatisfying to say the bear market may or may not be officially over, and that investors need to take the bad with the good. But I think we're in a period now where the key goal should not necessarily be to predict correctly when the bear will end and the bull will begin. The goal here to ensure participation in the market's biggest up days, which history tells us happens either during a bear market or very early in the new bull market—one of which describes where we are today.

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. August 14, 2022.
<https://www.wsj.com/articles/market-rebound-draws-wary-eye-from-some-investors-11660469378?mod=djem10point>

Weekly Market Update

Important Market News We Think Worth Considering

IN FOCUS THIS WEEK

- **Eating at restaurants vs. cooking at home**
- **U.S. consumer holds strong despite inflation pressures**
- **Growing calls that a “housing recession” is nigh**
- **China’s fiscal and monetary stimulus falls short of expectations**

Is It Cheaper to Eat at a Restaurant Versus Cooking at Home?

Many restaurants think so and have been designing ads trying to convince consumers of the same. Based purely on inflation figures, restaurants do have a point – over the past year, prices at grocery stores have risen by 13.1% while prices at restaurants are up about half that, at 7.6%. According to the Labor Department, this gap in inflation between grocery stores and restaurants is the biggest it’s been since the 1970s, which is leading restaurants to ramp up marketing of this relative value to consumers. Of all the ads run by restaurant chains, 58% highlighted deals or rewards from May to August, versus 46% from January to April. The difference in costs for grocery stores versus restaurants tends to center on prices of raw materials and labor, respectively. It is still ultimately cheaper to source meals from grocery stores, but only if the time spent preparing meals is not accounted for as a cost.¹

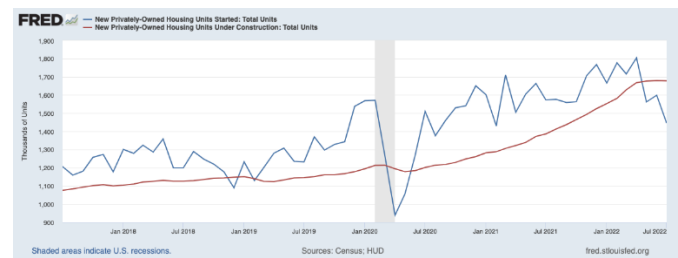
US Consumer Holds Strong Despite Inflation Pressures

Though gas prices have been falling in small increments over the last several weeks, they

remain elevated and inflation elsewhere in the economy has made life a bit more expensive for consumers. According to a Commerce Department report released this week, however, consumers appear to be holding strong despite higher prices. Overall retail sales, which captures spending online, at brick-and-mortar stores, and in restaurants, rose 0.7% from June to July when the data strips out gas and auto sales. Figures from the previous month were also revised higher, showing a 0.8% increase from May to June. The evidence here suggests that even though consumers are getting fewer goods and services due to higher prices, they are still willing to get out and spend.²

Growing Calls that a “Housing Recession” is Nigh

Homebuilders in the US are starting to send warning signals that activity is dropping off, and that the housing sector may experience some contraction in the months and quarters ahead. As seen in the chart below, housing starts in the US have been in decline since May (blue line), and the number of houses currently under construction has leveled off (red line). Housing starts in July dropped by nearly 10% from June to July, while building permits also fell by 1.3% over the same period.³



Source: Federal Reserve Bank of St. Louis⁴

This data comes as the National Association of Home Builders housing market index, which we think should be best viewed as a coincident indicator (not a leading indicator), fell for the

eighth straight month. The index reading for August was at 49, down from 55 in July and as low as it's been since the months following the global economic lockdown. Taken together, the data here suggests that tight supplies, rising prices, and higher mortgage rates are starting to take their toll on the housing market.

China's Fiscal and Monetary Stimulus Falls Short of Expectations

In past years, any inkling of weak economic activity in China generally prompted bold action from the government and the People's Bank of China, in the form of significant government spending and/or attractive loan incentives for households and businesses. With China's economy showing distinct signs of weakness in the wake of ongoing Covid-19 lockdowns and restrictions and a battered property sector, market watchers have been anticipating big steps from the government to boost the economy. It hasn't happened. The People's Bank of China cut two key interest rates last week, but interest rate cuts in China are not of the same meaning and magnitude of cuts by the Fed in the US. The response from the Communist Party in Beijing has also been muted. In response to the 2008 Global Financial Crisis, Beijing spent approximately three times what the US spent to charge up the economy. This time around, government officials have balked at announcing any new fiscal stimulus and instead have backed away from their goal of 5.5% GDP growth for the full year of 2022.⁵

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¹ Wall Street Journal. August 15, 2022. https://www.wsj.com/articles/restaurant-meals-become-a-relative-bargain-as-grocery-prices-soar-11660561200?mod=djemRTE_h

² Wall Street Journal. August 17, 2022. https://www.wsj.com/articles/us-economy-retail-sales-july-2022-11660683658?mod=djemRTE_h

³ Wall Street Journal. August 18, 2022. <https://www.wsj.com/articles/existing-home-sales-prices-housing-market-july-2022-11660774574>

⁴ Fred Economic Data. August 17, 2022. <https://fred.stlouisfed.org/series/HOUST#>

⁵ Wall Street Journal. August 16, 2022. https://www.wsj.com/articles/chinas-measures-to-boost-economy-dont-match-past-efforts-11660660175?mod=djemRTE_h

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