Capital Markets

Strategy Spotlight

Running The Numbers

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Strategy Spotlight: Running the Numbers

In a Nutshell

In *Strategy Spotlight*, we dive into hot topics in equities and notable updates in our top-down indicators. In the spotlight today, our latest thoughts on Russia's invasion of Ukraine from a stock market perspective. Three big things you need to know: (1) While the duration of growth scares in the S&P 500 since the Financial Crisis has ranged from two to nine months, recoveries back to pre-crisis highs have tended to take just 4–5 months, and on a 6- to 12-month time frame, the rebounds are quite robust in percentage terms. (2) Individual investor sentiment took another hit this week and remains well below pandemic lows, still sending a contrarian buy signal for stocks. (3) While stocks have fallen a bit more than we expected to start the year and we are mindful of risks to our view, we are sticking with our 5,050 year-end S&P 500 price target for 2022.

Recoveries from Growth Scares Tend to Take 4–5 Months; Rebounds Over the Next 6–12 Months Tend to Be Powerful

As we've continued to digest the latest developments in Russia's invasion of Ukraine and contemplate what it means for the US equity market, we've become even more convinced that the most appropriate way to think about this event is by comparing it to the various growth scares that have emerged in the post-Financial Crisis era. We list these on slide 4—they include the European debt crisis of 2010, the US debt downgrade of 2011, the industrial recession of 2015–16, and the sell-off of late 2018 sparked by QT and the China trade war. While we understand the impulse to look at stock market reactions to other military conflicts, we think these other events are more useful reference points, as they reflect the complexities of the current climate a bit more appropriately. All shocked the investment community with a previously unthinkable event of significant magnitude, and investors struggled to understand the implications for markets and the economy early on. All caused fears of recession to rise, though none resulted in an actual economic recession. The 2010 and 2011 shocks took place in the aftermath of a major crisis when markets still felt fragile in terms of the investor psyche. The 2018 China trade war was geopolitical in nature with ramifications for the global economy but also had the backdrop of aggressive Fed tightening layered in.

As we've discussed before, the average peak-to-trough drop in the S&P 500 ranged from 14% to 20% around each of these events and averaged 17.3%. As of Wednesday's close, the current drawdown has approached 12%, not quite in growth scare territory but getting close. We took a look at what happened after the stock market bottomed in each of the previously mentioned growth scares. Interestingly, though the duration of the drawdowns varied, ranging from two to nine months, there was a remarkable degree of consistency in the time that it took for the stock market to return to pre-crisis highs, just four to five months. Six to 12 months later, the total recovery off the trough averaged 24–30%. See pages 4–5 for the full details.

(Continued on page 3)

Strategy Spotlight: Running the Numbers (continued)

Individual Investor Sentiment Has Taken Yet Another Hit and Remains Below Pandemic Lows

We pointed out in last week's *Russia Rundown* that geopolitics do appear to matter to the American psyche. Biden's polling numbers fell sharply last August as the US announced its withdrawal from Afghanistan (see page 6). Not surprisingly, individual investor sentiment also took yet another hit in this week's AAII update. As of 2/24/2022, net bulls were at -30.3% on a weekly basis, the lowest level we've seen since April 2013 and well below pandemic lows of -29% (page 7). On a four-week average, this indicator is now at -20.7%. This suggests that stocks are already deep in oversold territory, since below the -10% threshold the S&P 500 has been up 15% on average over the next 12 months 86% of the time.

As we discussed in Tuesday's *Hedge Fund Handbook*, we eagerly await today's CFTC release to see whether, and to what degree, S&P 500 futures positioning got hit this week. While Nasdaq and Russell 2000 futures positioning among asset managers has been looking slightly oversold and the froth has been pulled out of S&P 500 futures positioning, the latter has still had some distance to travel before reaching past lows, which we would consider to be another contrarian bullish sign for stocks.

Sticking with Our 5,050 S&P 500 Price Target for Now

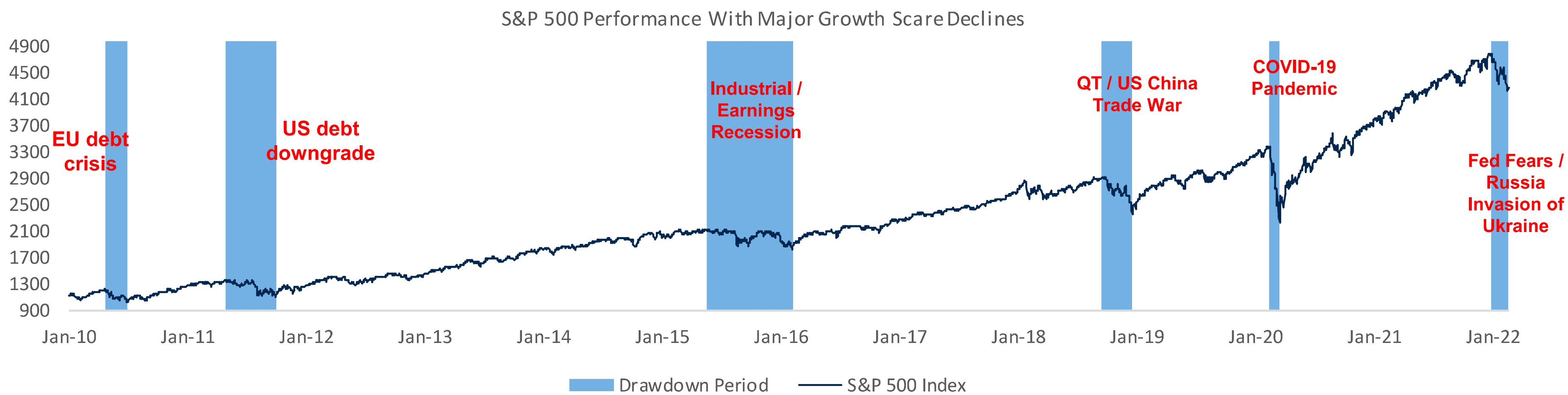
Stressful, emotional times in the stock market require a calm review of the numbers. We worry that there's simply too much we don't know about how the current geopolitical crisis will develop and that the investment community and Corporate America are in the early days of understanding all of the derivative impacts of unfolding events. But we also know that bottoms in the market feel terrible and frenzied. Our sentiment analysis and our work showing how quickly stocks tend to recover from growth scares are telling us to be on the lookout for a positive inflection in the stock market, even if it is not at hand just yet.

And on this point, it's worth noting that if the S&P 500 ends up falling a total of 17.3% from its early January high to 3,967 (in line with the average growth scare drop) and then rebounds 27.8% over the next 10 months (its average 10-month gain following a growth scare trough), it would get to 5,070 around year-end—right in line with our 5,050 year-end price target. The possibility that the US economy might get pulled into a recession, or something close to one, due to an overly aggressive Fed and derivative impacts from Russia's invasion of Ukraine is clearly the main risk to our view. But for now, we see this as a risk to monitor with vigilance, not an assumption that ought to drive our base case, particularly since our US economics/rates strategy teams are sticking with their call for only four hikes from the Fed this year. We think a more likely outcome is that economic growth will moderate a bit relative to current expectations, which have been well above average. An earlier than expected return to trend-like GDP growth is something that may pull forward the shift in market leadership from Value back to Growth, but isn't something that we would see as derailing the stock market for the full year.

Post-Financial Crisis Growth Scares Have Been Accompanied by Drawdowns in the 14–20% Range

Key Takeaways

- Since the Financial Crisis, major growth scares have been accompanied by drawdowns of roughly 14–20%. All of these have represented buying opportunities, with strong rebounds averaging 24–30% in the 6–12 months that followed.
- As of late February 2022, the current drawdown has reached ~12%, not quite in growth scare territory. A 17.3% drawdown, in line with the average of the events we examined, would take the index to 3,967. If we then factor in the average 10-month rebound of 27.3% (assuming a bottom is found relatively soon), the index would end 2022 at around 5,070.



S&P 500 Growth Scare Pullbacks Post 2010: Peak To Trough Declines & Performance Post Trough

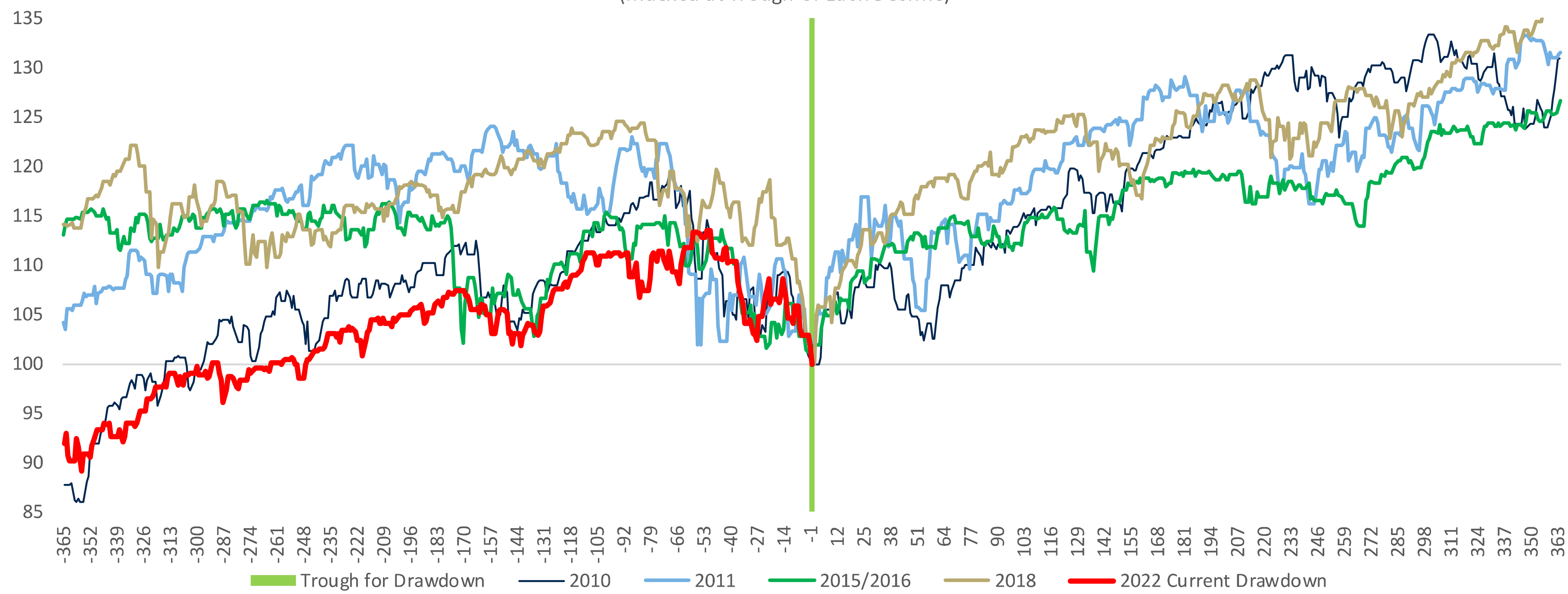
S&P 500 Decline Details								Performance Post Trough					
Peak Date	Trough Date	Duration (# Calendar Days)	Peak Price Level	Trough Price Level	% Decline	Peak Current Year P/E Level	Trough Current Year P/E Level	5 Trading Day Return	1 Month Return	3 Month Return	6 Month Return	10 Month Return	12 Month Return
04/23/2010	07/02/2010	70	1217	1023	-16.0%	14.2	12.0	5.5%	10.1%	12.1%	23.0%	33.1%	31.0%
04/29/2011	10/03/2011	157	1364	1099	-19.4%	13.9	11.2	8.7%	14.7%	16.2%	28.6%	26.5%	28.7%
05/21/2015	02/11/2016	266	2131	1829	-14.2%	18.0	15.4	4.8%	10.6%	12.9%	19.5%	23.5%	26.6%
09/20/2018	12/24/2018	95	2931	2351	-19.8%	18.0	14.4	6.8%	12.4%	19.0%	25.3%	28.0%	37.4%
Median		**126**			**-17.7%**			**6.1%**	**11.5%**	**14.5%**	**24.1%**	**27.3%**	**29.8%**
Average		**147**			**-17.3%**			**6.5%**	**11.9%**	**15.0%**	**24.1%**	**27.8%**	**30.9%**
% Times Up								**100%**	**100%**	**100%**	**100%**	**100%**	**100%**

Source: RBC US Equity Strategy, Bloomberg, FactSet, Thomson. As of late February 2022

Drawdown Durations Vary; Recoveries from Growth Scares Tend to Take 4–5 Months

Key Takeaways

- In the four instances of a "growth scare" pullback post GFC, we've seen that the S&P 500 took on average five months for the entire drawdown to occur (within a range of 2–9 months), while the recovery (getting back to the pre growth scare peak) took 4–5 months each time.



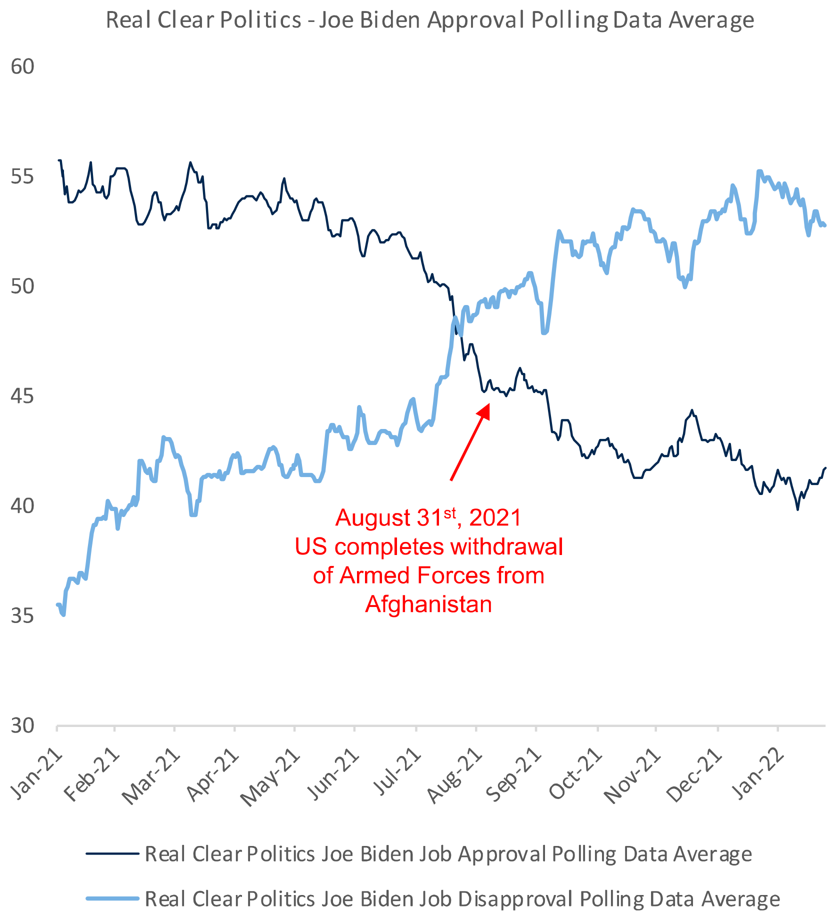
S&P 500 Performance With Major Growth Scare Declines	Peak Date	Trough Date	Duration in # of Calendar Days	Drawdown Duration Esimated # of Months	Full Recovery Date	Full Recovery Duration	Full Recovery Duration From Trough Esimated # of Months
2010 - European Debt Crisis	04/23/2010	07/02/2010	70	2.3	11/04/2010	125	4.2
2011 - US Debt Downgrade	04/29/2011	10/03/2011	157	5.2	02/24/2012	144	4.8
2015 / 2016 - Industrial Recession	05/21/2015	02/11/2016	266	8.9	07/11/2016	151	5.0
2018 - QT / US-China Trade War	09/20/2018	12/24/2018	95	3.2	04/23/2019	120	4.0
2022 - Fed Tightening / Russia Invasion of Ukraine	01/03/2022	02/23/2022	51	1.7	*TBD*	*TBD*	*TBD*
Average ex 2022			147	4.9		135	4.5

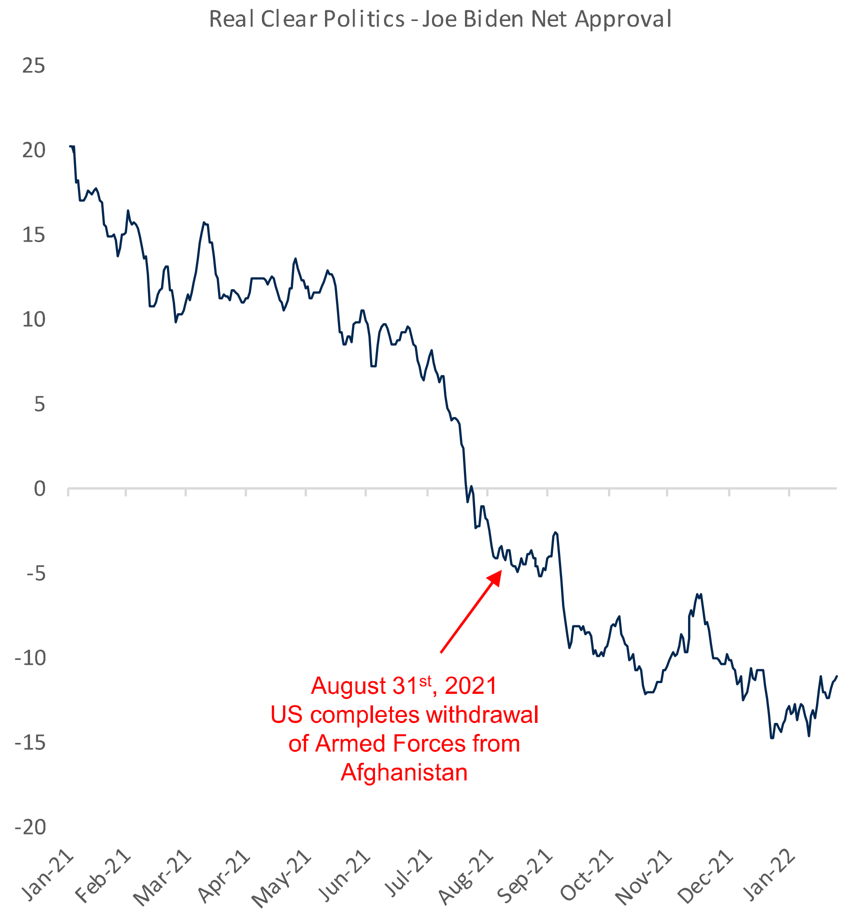
Source: RBC US Equity Strategy, Bloomberg

Biden's Approval Fell Sharply as the US Withdrew from Afghanistan

Key Takeaways

- Joe Biden's net approval rating has fallen sharply since he took office. Interestingly, a major leg lower occurred as the US Armed Forces were withdrawing from Afghanistan. Since then, his net approval has continued to fall, but it has somewhat stabilized recently, near the lowest levels we have seen it since he took office. We think Biden's handling of the Russia/Ukraine crisis could also impact his polling numbers, which could also have a read-through to investor and consumer sentiment.



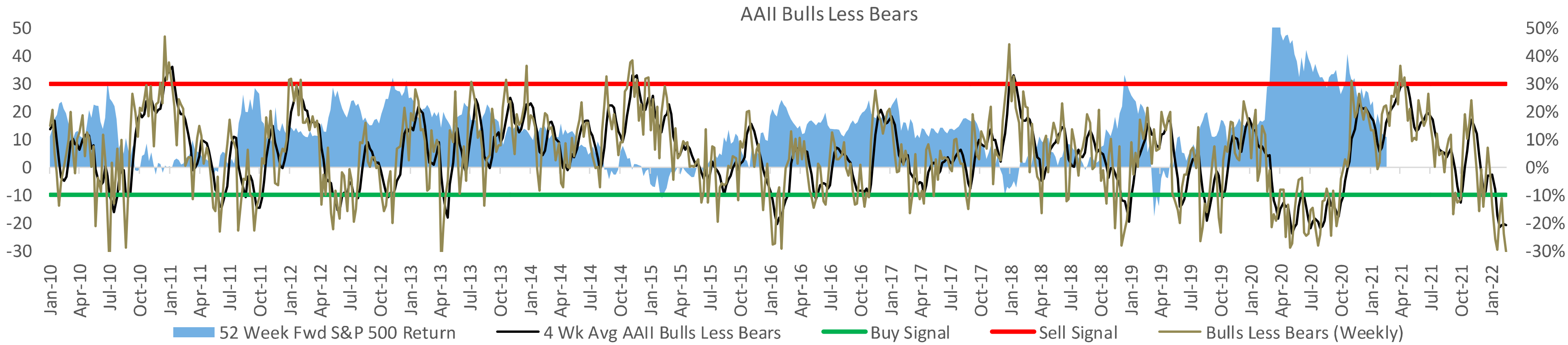


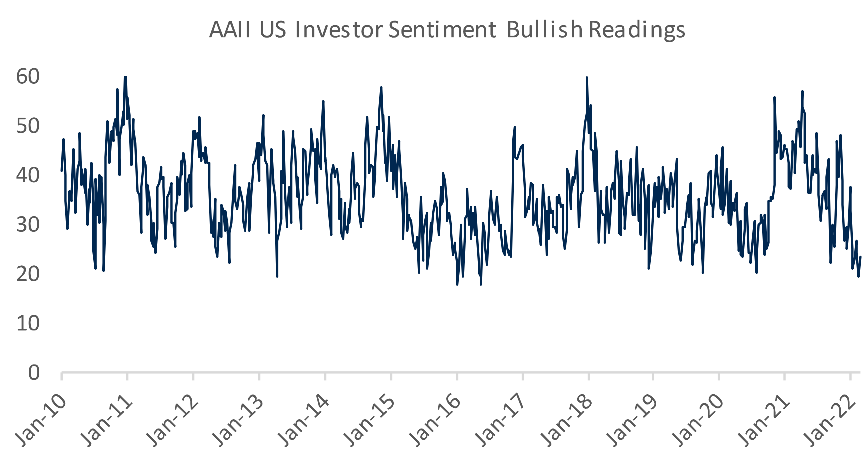
Source: RBC US Equity Strategy, Real Clear Politics, Bloomberg. As of 02/23/2022

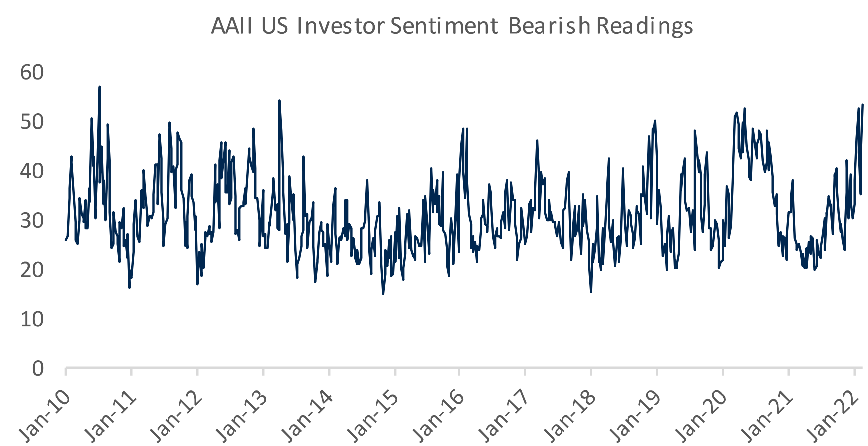
Individual Investor Sentiment Now Below Pandemic Lows

Key Takeaways

- After some signs of stabilization in late 2021, net bulls fell once again in early January 2022 in the weekly AAII survey, declining to -29.8%, reaching pandemic lows (-29%). As of our latest update, captured 2/24/2022, net bulls were at -30.3% on a weekly basis, the lowest level we've seen since April 2013.
- On a four-week average, this indicator is now at -20.7%, well below our "buy signal" threshold and signaling that we are deep in oversold territory. Below the -10% threshold, the S&P 500 has been up 15% on average over the next 12 months 86% of the time. On a three-month forward basis, it's been up 5% on average 84% of the time.
- Sentiment has been languishing on this survey for the last few months—a key difference from other growth scare periods such as 2011, 2015, and 2018 when sentiment was highly bullish to start each year.





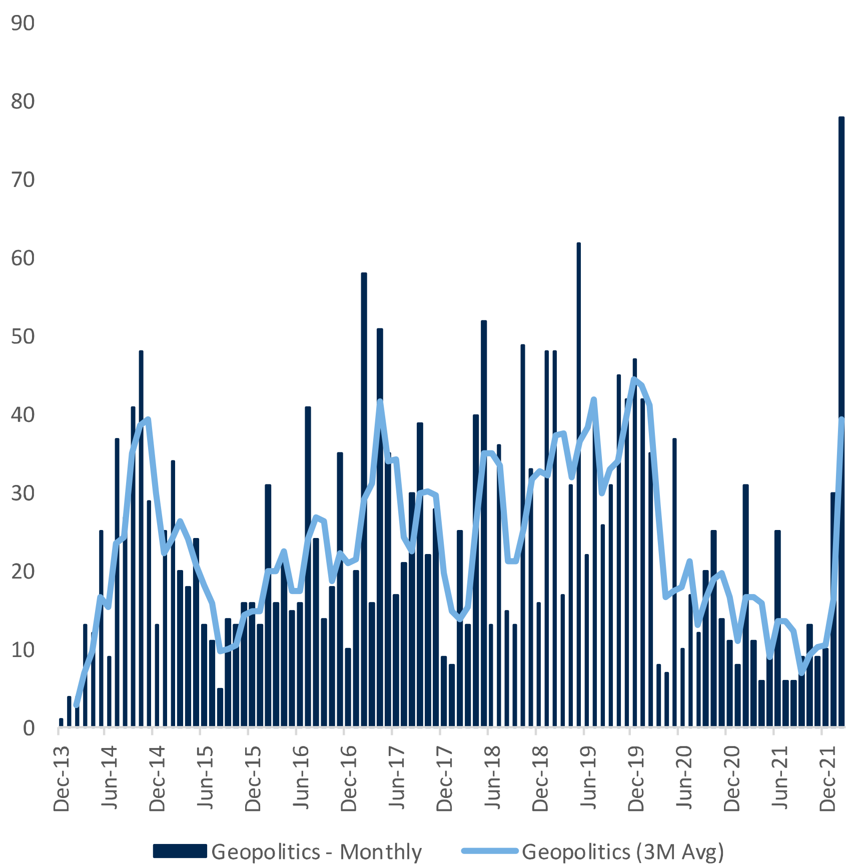


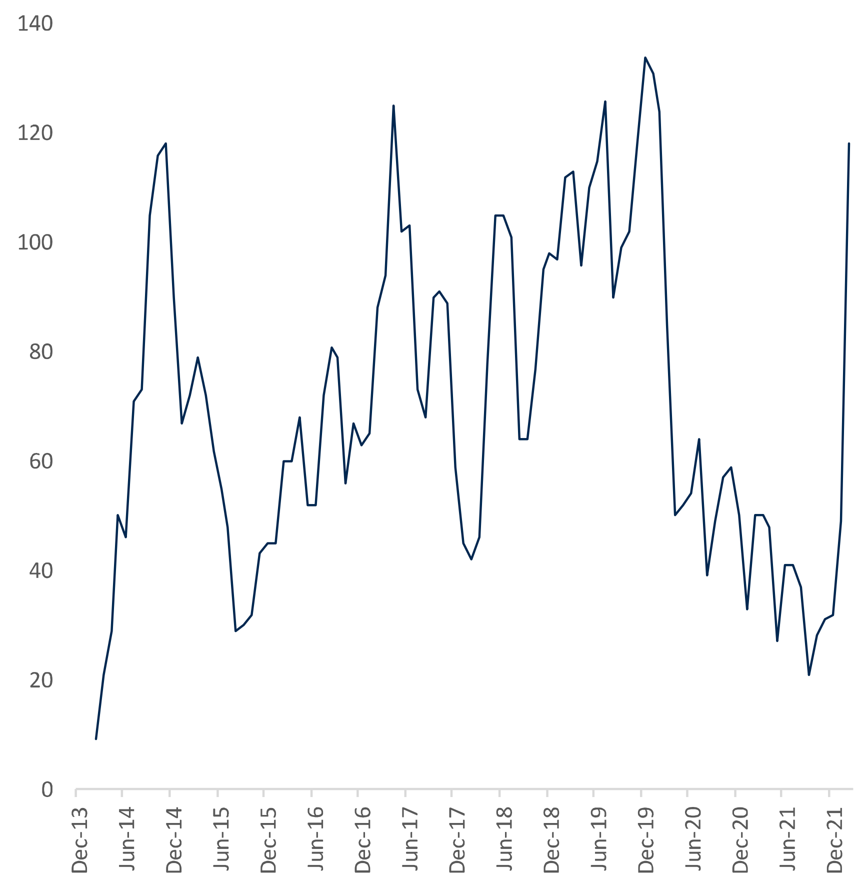
Source: RBC US Equity Strategy, AAII, Bloomberg. Performance and AAII as of 02/24/2022

Geopolitics Have Taken Center Stage in February

Key Takeaways

- Mentions of "geopolitics" and related topics had been trending well below pre-pandemic levels but picked up sequentially in January 2022 and have spiked sharply in February, based on preliminary data for the current month.





Source: RBC US Equity Strategy, Bloomberg. Transcript analysis is based on mentions through earnings calls for S&P 500 companies. Latest data point is preliminary as of 02/23/2022

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