Clients

I agree here – expect another 15% decline if hx repeats ... & we will be Buyers

Today's Market

We've Only Just Begun

May 25, 2022 5:17 AM ET AMGN, BHP, BMY... 35 Comments 39 Likes

Eric Parnell, CFA
30.92K Followers

Summary

- Today's stock bear market has only just begun.
- No relief in sight.
- Elevate your stock investment strategy to find opportunities that remain abundant within the broader market.

Panya Riamthaisong/iStock via Getty Images

Seems like such a long time ago. U.S. stocks have officially descended into a bear market. For many, this *will* be the first bear market in stocks that they have experienced in their investing lifetime, as it has been more than 13 years now since the calming of the financial crisis and the end of the 2007-09 bear market. I emphasize the word "*will*" in the last sentence for a very important reason - while I hear many investors lately throwing around the word "capitulation" and searching for the imminent stock market bottom, we are instead much more likely in the very early stages of a bear market decline that may continue well into the foreseeable future. But this dire outlook does not mean that the stock market is still not rich with upside opportunities going forward.

Agree – Avg ↓ is 35% so
expect another 15%

Wait just a minute! How can I say that this will be the first bear market for many investors? What about just two years ago when the onset of the COVID crisis sent the S&P 500 into a -35% tailspin in just over a month from February 19 to March 23, 2020? Wasn't that one mean and angry bear market that we all just experienced? By the "20% decline from previous stock market peak" definition that many investors apply, the answer to these questions would be "YES". But what took place in early 2020 is not what I consider a true bear market. Instead, I view it as a market shock, but not a bear. Why? Because while it was certainly traumatic in terms of magnitude, it was fleeting it terms of duration. Agree - I repeatedly make this point

A true bear market. In my view, a true bear market is one that not only bruises investors in the magnitude of the decline, but also through the gut-wrenching market swings that extend over time. A true bear market is one that begins by relentlessly and repeatedly taking down the past bull market leaders until the once habitual dip buyers are ultimately driven to extinction and exhaustion (tech and crypto come to mind today). Once it is finished devouring the previous market leaders (we are still far from having arrived at this next stage today - a lot of tech, tech adjacent, and crypto cleansing still needs to be done), the true bear market then turns its eyes on the broader equity market and increasingly hunts those investors that fled to seek refuge in the previously more defensive and out of favor areas of the market. It teases investors with sustained relief rallies only to be followed by even more punishing drops to new lows. By the time a true bear market is draws to a close, investors are throwing in the towel and dumping just about any and every stock overboard. This is where we ended up in late 2002/early 2003. This is where we ended up in late 2008/early 2009. And generationally cheap and extraordinarily attractive buying opportunities as far as the eye can see are left for investors that are willing to venture back into the stock wilderness. So NO rush to Buy

This is a process that does not take place over the course of a month or six months. Instead, the true bear market cycle needs to play out over a year or two or more. And the higher and longer the previous bull market cycle was allowed to run unabated (even without nixing the early 2020 COVID shock, the previous bull market cycle that started in 2009 ranked as the longest in U.S. history), the longer and deeper the subsequent bear market cleansing process is likely to be.

Why now? We've seen extended stock market corrections play out a few times since 2009, and each time they presented fantastic buying opportunities: Summer/Fall 2010, Spring/Summer 2011, Q2 2013, 2H 2015 to Q1 2016, Q4 2018, Winter/Spring 2020. All ended up being great buying opportunities. So what exactly makes today different? Because each and every time over the past thirteen years, the U.S. Federal Reserve had the stock investor's back. The U.S. stock market simply had to sneeze (or fall anywhere between -5% to -12% over a four to eight week period) and the Fed would come running with interest rate cuts and asset purchases and reassuring promises that everything was gonna be all right. Shhh, stock investor, shhh. Everything is gonna be OK.

i.e., the "Fed PUT" was at play

But that's not at all what's happening today. The S&P 500 has already fallen by more than -20% peak to trough since the start of January, and the Fed is not only not lowering interest rates or promising another round of balance sheet expanding QE or trying to jawbone the market higher. Instead, they are arming up for a few more rounds of 50 basis point rate hikes in the coming months. At the same time, they are getting ready to start *shrinking* their balance sheet starting on June 1. Pull yourself up by your bootstraps, stock investor, because the Fed's not going to save you this time. Fed out!

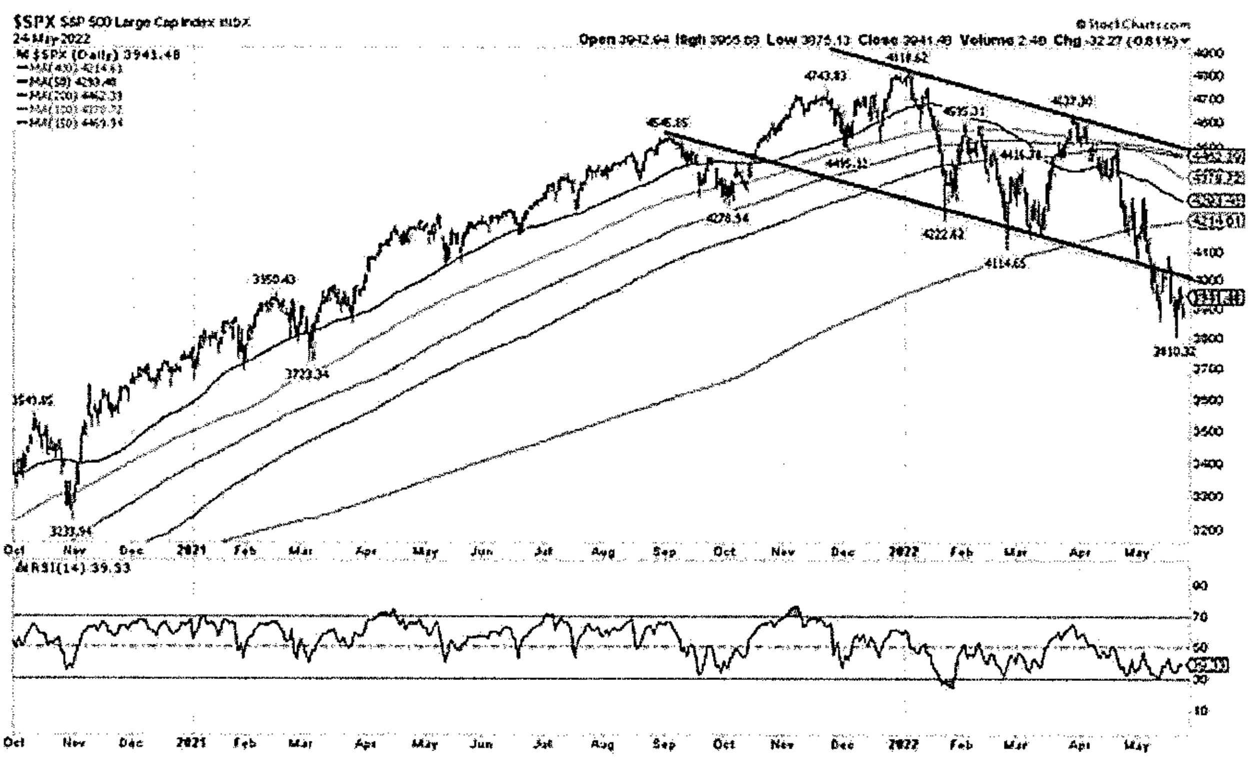
No relief in sight. Even if recently soaring inflation pressures start to abate in the coming months, which I fully expect they eventually will (while the Fed has drawn a lot of scorn for having suggested at one time that inflation pressures would be *transient*, I believe they will ultimately be proven correct - the only problem is that what still qualifies as *transient* at about 10 months and counting sure as heck feels *sustained* to the general public - just like a true bear market, true *sustained* inflation is something that plays out over many years if not a decade or more), it will take even longer before the Fed starts to back down from deploying all of its inflation fighting firepower. As a result, the stock market dampening effects of tightening monetary policy will likely persist for some time into the future even if the Fed gets the chance to start cooling it off a bit in the second half of 2022.

So stock pickers market
NOT Broad ETFs or Funds!

Elevate your stock investing strategy. All of this sounds hopelessly bearish, but it's not. Stock investing is not supposed to be easy. Only the last decade or so made it seem easy thanks to the endless flow of monetary support from the U.S. Federal Reserve. The reality is that today's stock market is still rife with opportunities. The key is staying nimble and focusing on selected areas of the market that can still perform even as the broader S&P 500 Index is declining. More on this point in a minute.

Where do we stand today? Let's first consider where we've travelled so far this year and what we should reasonably expect from the S&P 500 going forward.

S&P 500: Increasingly Breaking Down



Source: Gerring Capital Partners, StockCharts.com

StockCharts.com

on intraday

As mentioned previously, the S&P 500 Index has already fallen more than -20% peak to trough since early January. In the process, the benchmark index has definitively broken below all of its key moving average support levels including the ultra long-term 400-day moving average (pink line). Thus, while a countertrend rally might reasonably be expected in the coming weeks given the slope of the decline since late March, any such bounce should reasonably be expected to fail not far above 4200 where the increasingly flattening 400-day moving average resides and is quickly being joined by the medium-term 50-day moving average (blue line) that is descending toward this same level.

Unfortunately, the prospects for even a modest bounce scenario on the S&P 500 toward 4200 is bleak for the following reasons. First, the S&P 500 not even close to oversold from a Relative Strength Index (RSI) perspective despite the magnitude of the decline since late March. Next, the benchmark index has spent the month of May breaking down below the support line in its downward sloping trading channel dating all the way back to last September. So not only has the S&P 500 already erased nearly all of its gains from what was an otherwise fantastic 2021, but it appears to have at most 50 to 100 points of further short-term upside (+1% to +3%) on any short-term bounce before getting pushed back to the downside.

So where is the stock opportunity? A key point to always remember about stock investing is that while the overall stock market as measured by the S&P 500 may be falling, this does not mean that selected sectors, industries, sub-industries, or individual stocks within the S&P 500 are not strongly rising at the very same time.

Energizing Investors

Source: Gerring Capital Partners, StockCharts.com

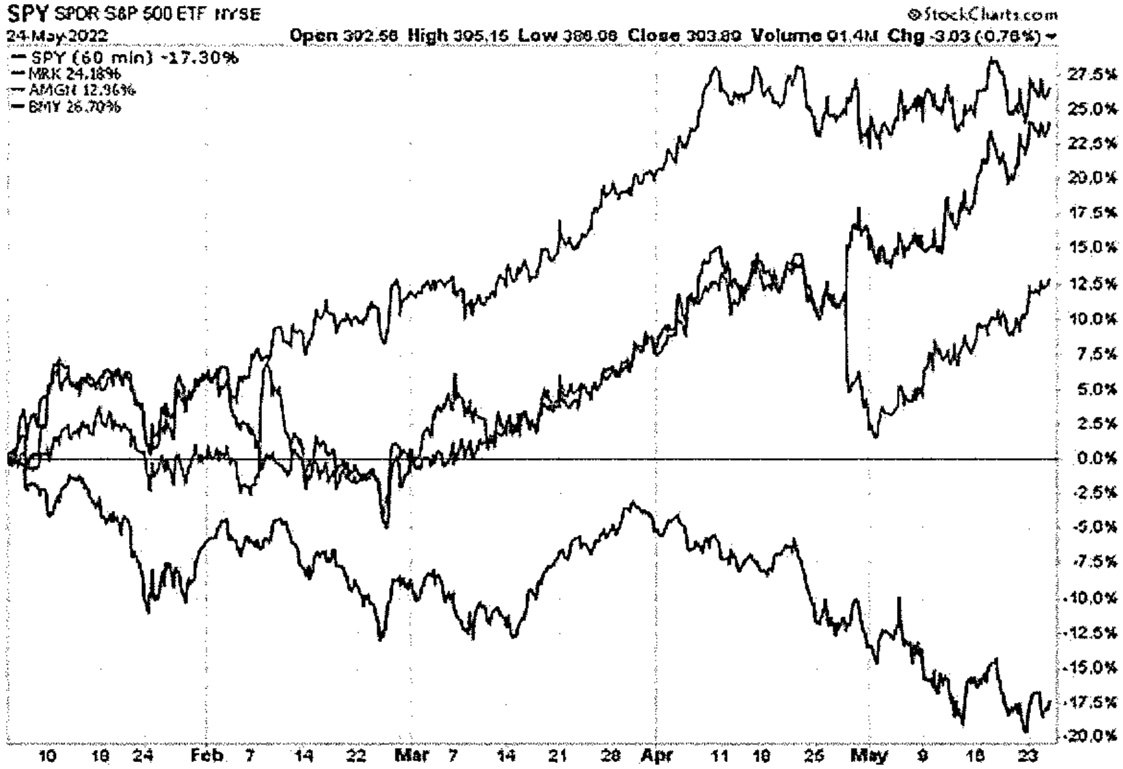
StockCharts.com

we have done very well here

Energy: Consider the performance of the energy sector (XLE) within the S&P 500 Index. Whittled to a minimal weight in the benchmark index having finished at the bottom of the sector table in five out of the last eight calendar years, the energy sector roared to life in 2021 notching a +55% gain to outperform the S&P 500 by nearly 2x last year. And the energy sector is continuing its hot streak in 2022 in a hot inflation environment that is tailor made for having overweighting the sector some time ago. To this point, I have been long the likes of Chevron (CVX), Shell (SHEL), and BHP Billiton (BHP) since early to mid 2021.

e.g., TOU

Treatment For An Ailing Stock Market



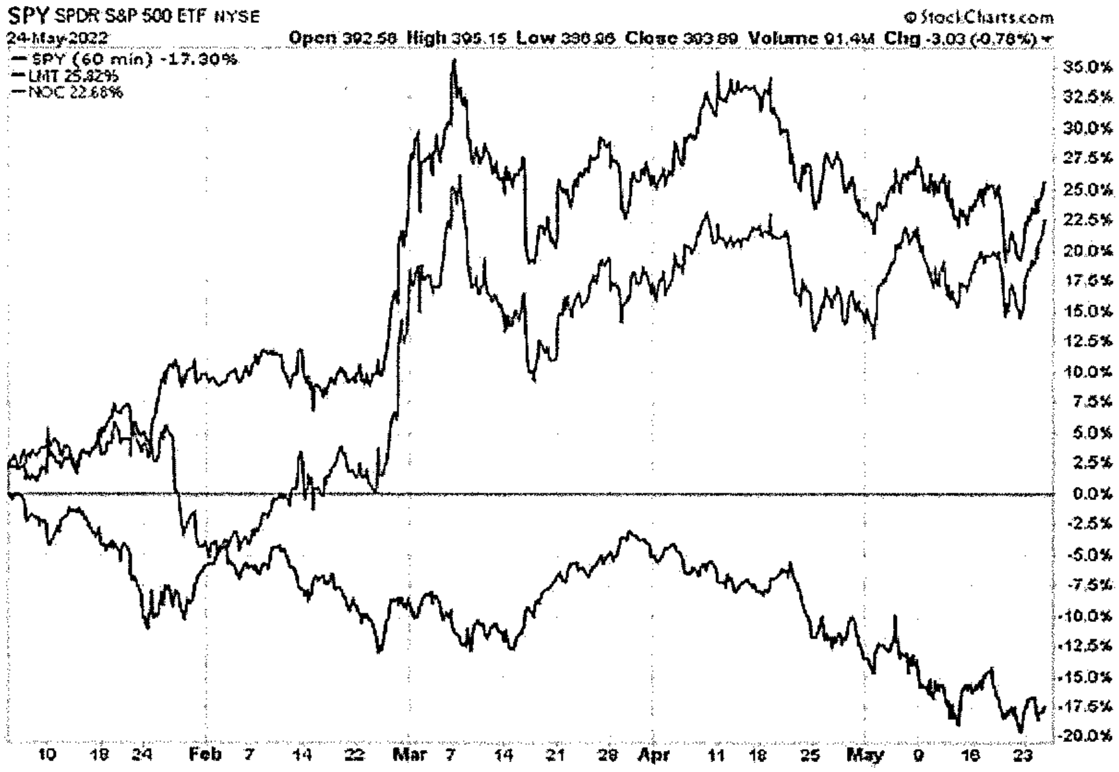
Source: Gerring Capital Partners, StockCharts.com

StockCharts.com

Big pharma. Also consider the performance of big pharmaceutical and biotech stocks like Merck (MRK), Bristol Myers Squibb (BMY), and Amgen (AMGN). All three stocks are higher by double-digits during this same period where the S&P 500 has descended into a bear market. I have been long all three for at least a year including Merck, which has been a portfolio cornerstone since 2016.

Our SYK & RYH will rebound

A Good Offensive Strategy Is To Focus On Defense



Source: Gerring Capital Partners, StockCharts.com

StockCharts.com

Defense. Then we have aerospace and defense stocks, which were trading at a deep historical discount in an otherwise grossly overvalued broader stock market heading into 2022. Names such as Lockheed Martin (LMT) and Northrop Grumman (NOC) have generated +20% returns so far this year driven in large part by unfolding geopolitical events. I have been long both stocks since the end of 2020.

Also consumer staples (DOL)
+ utilities (FTS, BEP)

Bottom line. These are just a few of the many segments within the S&P 500 that have performed exceedingly well so far in 2022 despite what has been a dismal year for the broader market. Just because these segments have performed well so far this year does not mean that they will continue to do so for the remainder of the year. This is particularly important to remember given that the weight of the bear market is likely to become heavier on the overall market as circumstances continue to unfold. But what this shows is that upside opportunities in stocks remain abundant. The key is looking somewhere other than the previous bull market leaders to find them.

This article was written by

Eric Parnell, CFA

30.92K Followers

Assistant Professor of Business and Economics, Ursinus CollegeFounder and Director, Gerring Capital PartnersContrarian value investor across the broad array of asset classes - stocks, bonds, commodities, alternatives - with an emphasis on risk management and downside protection.

Disclosure: I/we have a beneficial long position in the shares of CVX,SHEL,BHP,MRK,BMY,AMGN,LMT,NOC either through stock ownership, options, or other derivatives. I wrote this article myself, and it expresses my own opinions. I am not receiving compensation for it (other than from Seeking Alpha). I have no business relationship with any company whose stock is mentioned in this article.

Additional disclosure: This article is for information purposes only. There are risks involved with investing including loss of principal. Eric Parnell and Gerring Capital Partners makes no explicit or implicit guarantee with respect to performance or the outcome of any investment or projections made. There is no guarantee that the goals of the strategies discussed by Eric Parnell and Gerring Capital Partners will be met.