Rochester Financial Services

Fee-Only® Financial Management Services

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February 5, 2022	Dow-Jones	S&P 500	NASDAQ	Russell 2000	10 yr Treas	Bitcoin	Gold	Crude Oil
	35,090	4,501	14,098	2,002	1.93%	41,574	$1,809	$91.92

Investment Strategy Report

Stocks Get Routed in January, But Did We Hit Bottom Last Week?

It was only a month ago that the new year was getting started, and the prospects for the stock market looked so promising. Stocks initially fell after Thanksgiving when the Omicron variant first hit, but they then recovered when it appeared that the variant was less virulent. And they continued to move higher in December, as investors expected that the number of new virus cases would soon be peaking.

But January was a completely different story. In retrospect, we can see now that the stock market was riding on a high, moving higher but without a strong foundation. The crack in that foundation turned out to be inflation, and fears that the Federal Reserve would no longer be accommodative, putting an end to the stock market party. Stocks got hit hard, and technology and small cap stocks got hit the hardest. Stocks declined steadily throughout the month. And then on Monday, January 24th, stocks collapsed. The S&P 500 dropped 4.0% and the Nasdaq, 4.9%, huge one day drops. At the market bottom that day, the S&P was 12% below its previous record high, and the Nasdaq was down over 18%. But the day didn't end that way, as stocks staged a remarkable recovery, finishing up for the day.

Since then, stock market volatility has remained high, but stocks have managed to stabilize somewhat and move a few percentage points higher. So did that turnaround Monday mark a market bottom? Was the 10% market correction that many analysts had been predicting for some time in this year's first half, occur earlier than anticipated? And now that it has occurred, can the uptrend continue?

The bulk of the analysis that I have assembled in the past few weeks seems to suggest that yes, the uptrend can now continue. But having been burned once, I would say that caution is called for.

Tom Lee (Fundstrat), who last month called for S&P to hit 5,000 in January, was back on CNBC this Friday (2/4) and said that he is "leaning into this weakness" because 1) the underlying economy remains strong, 2) interest rates are still relatively low, and 3) investors have panicked and sentiment has collapsed, which is bullish from a contrarian perspective. He is now "risk on" for equities and believes that February will be a rally month.

The people of Sentimentrader.com have been busy assessing market sentiment and have come up with several studies that suggest that stocks can move higher. 1) The surge in their optimism index points to higher stock prices. This is especially the case for the technology sector. 2) "The recent sharp decline and rebound in the High Yield Bond indicator qualifies as a favorable sign for stocks". And 3) the extremely bearish sentiment in the AAII survey indicates that traders have become too pessimistic on the outlook for stocks. "Similar setups to what we're seeing now have preceded rising prices for the S&P 500, with a 3 month win rate of 88%".

Steve Sjuggerud (StansberryResearch.com) agrees that investors have gotten too bearish, and also addresses the low bullish reading in the AAII survey. "When the AAII bullish reading dropped to 21% or less, which has only happened 3% of the time, 97% of those extremes led to gains in the S&P 500 over the next year".

However, Bob Brinker (BobBrinker.com) reminds us that when the month of January is a negative one for the market, stocks tend to struggle the rest of the year, gaining an average of only 2.7% from February through December. He expects more periods of high volatility for stocks during the first half of the year. He is concerned that Fed monetary tightening, ongoing supply chain disruptions, and heightened geopolitical uncertainty can lead to further stock market corrective activity. "Given that this is a mid-term off-presidential election year, there is the potential for a buying opportunity to develop later this year". As is often the case, caution and patience might pay off for investors this year. *Jeff Feldman*

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