

Rochester Financial Services

Fee-Only™ Financial Management Services

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Dow Jones	S&P 500	NASDAQ	Russell 2000	10 yr Treas	Bitcoin	Gold	Crude Oil
32,916	4,121	12,061	1,890	3.04%	31,459	\$1,840	\$119.44

Investment Strategy Report

End Of Month Rally Erases Losses For May. Is This A Bear Market Rally?

We all know how bad April was for the stock market. The only thing worse would have been if the selling had continued in May, compounding the losses. Unfortunately, that's how things started last month, as the S&P 500, at its low point on May 20th, was down 7.8% for the month. The Nasdaq fared worse, as that index was down 10.5% for the month at its low point that day. The good news is that stocks staged a rebound to end the month, as the S&P ended the month flat and the Nasdaq finished down only 2%. The bad news is that everyone and his uncle feel that this rally off of the lows is a bear market rally, merely a respite from the selling. And that those hoping for a V-shaped recovery will be sorely disappointed.

Those views are definitely understandable. Inflation, as measured by the consumer price index, is at its highest point in 40 years. Gasoline prices are at their highest levels ever. Add to that the sky high home prices and food prices, and the Federal Reserve in the midst of raising interest rates, you can see why people in general and investors in particular are worried. Are their concerns justified? Is now the time to cash out of our investments to ride out the storm?

No one knows the answer to this question, but for those investors with at least a 3 year time horizon, my recommendation is that cashing out now is probably not the best course of action – that stock prices will likely be higher 6-12 months from now. Here are my reasons:

Back last fall, inflation was still at a reasonable level, Americans were vaccinated and boosted, we were emerging from the pandemic, the economy was poised to rebound, and yet, as we now know, that would not have been an opportune time to invest. As it turns out, the stock market looks into the future, typically 6-9 months ahead, and behaves accordingly. Conversely, now, with all the problems I've cited above, the stock market might foresee a period later this year and early next when interest rates stabilize, inflation numbers begin to come down, our strong labor market leads to strong corporate earnings, and Americans leave the pandemic behind and economic growth continues its uptrend.

The analysts at Sentimentrader.com cite several studies that also argue against this being a bear market rally. A study they published on 5/31 stated "From the data that we do have, it's clear that the type of decline we saw heading into May and then the rebound of buying interest over the past several sessions is that type that has consistently led to further gains in the months ahead". On 6/3 they wrote "General US consumer sentiment toward stocks is the worst in over a decade. It's also historically pessimistic toward the bond market. Combined stock and bond sentiment is the worst in history, which should be a good sign for both markets. The pessimism has spread to the general consumer, and they have had a pretty reliable record of becoming overly concerned (or euphoric) at the wrong times". And in a study they published today (6/6), they stated that "The "story" is that technology sector stocks got "too overvalued" during the 2020-2021 bull market and are now due for a comeuppance on a par with the 2000-2002 bear market. Any maybe they are. But the potential "fly in the ointment" to this line of argument is that technology corporate insiders are bullish and retail traders are bearish. Historically, that is a recipe for favorable action, not a continued bearish decline".

The analysts at StansberryResearch.com point out (5/24) that the S&P 500 recently hit a 52 week low. This has only happened 23 times since 1950. The typical returns from this point going forward average 4.5% after 6 months, 7.4% after 1 year, 24% after 2 years, and 31.2% after 3 years. They add that there can always be additional pain in the short term, but longer term investors should be fine. Bob Brinker, in his May newsletter writes that "we expect the S&P 500 to challenge the 5,000 level by the first half of 2023 (a 21% gain from here). This should provide time for the market to adjust to the FOMC monetary tightening cycle, and also allow time for the global supply chain to move closer to normalization, and inflation to recede".

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