January 4, 2019

ONLY A MATTER OF TIME
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An old cliché says the price is truth, but there are times when price alone does not tell the whole story. We think this is one of those times.

The direction of stock prices typically guides investors’ views of the equity market. Since early last October, the market’s sharp downturn dampened enthusiasm about the market’s prospects. This was abundantly clear in the late-December American Association of Individual Investors weekly sentiment survey, which showed the highest percentage of bearishly-biased respondents in five years. A close look at the market’s internal characteristics, however, reveals a condition similar to what was present at several key turning points for the market.

Selling intensity at times can shove stocks below the technically important 50-day moving average. When the percentage of stocks in this condition reaches an extreme, often the market is not far from a turning point, which is what this measure suggests is in place now.

The red vertical lines in the chart below (courtesy of StockCharts.com) illustrate the percent of S&P 500 stocks below their 50-day moving averages. The black line is the S&P 500. As the chart shows, after each of the prior three times when this percentage was at or below where it is now, the market had strong recoveries. Perhaps more importantly, underlying economic and equity fundamentals now are far better than they were in the three prior periods.

In 2008, the U.S. economy was on the cusp of the biggest economic contraction since the 1930s. In the summer of 2011, Standard & Poor’s downgraded U.S. sovereign debt for the first time by cutting the rating from AAA to AA+. Although the 2015 period had some concerns similar to what investors worry about now, a sharp rise in the personal savings rate suggested that previous strong consumer activity was ebbing, which considering the dominance of the consumer in the U.S. economy prompted concern that GDP growth would slow notably. The market eventually cast aside lower GDP growth in 2016 as it looked ahead to the presidential election and what eventually would be a major upswing in GDP growth and corporate earnings.
Today, the economy appears poised for still solid but somewhat slower GDP growth, but a recession does not appear to be on the horizon. Corporate earnings growth likely will slow from the torrid pace experienced in 2018, but growth still should be solid. The financial crisis that produced the 2008-2009 recession led to reforms that today finds the U.S. banking industry in its best fiscal condition ever.

The extreme condition in the percentage of S&P 500 stocks below their 50-day moving averages does not imply that the market will have an immediate turnaround. However, the extreme represented by this measure now suggests that the eventual outcome could match what has happened in the three prior periods addressed here as well as similar conditions in years before 2008.

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