Market Strategy
by STRATEGAS A BAIRD COMPANY

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Market Strategy Weekly

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This week we spoke with Strategas Technical Strategist Todd Sohn about what to expect for Year 2 off of a bear market low, especially within the context of a longer-term structural bull market. That conversation—lightly edited for length—is below.

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YEAR 2 OFF THE LOWS | VOLATILITY EXPECTED | STRUCTURAL BULL MARKET INTACT

ROSS MAYFIELD: We just capped the first year off the Covid-19 bear market low, with the S&P 500 up ~75%. You dove into what Year 2 off a bear market low looks like; could give us a couple high level takeaways from your research there?

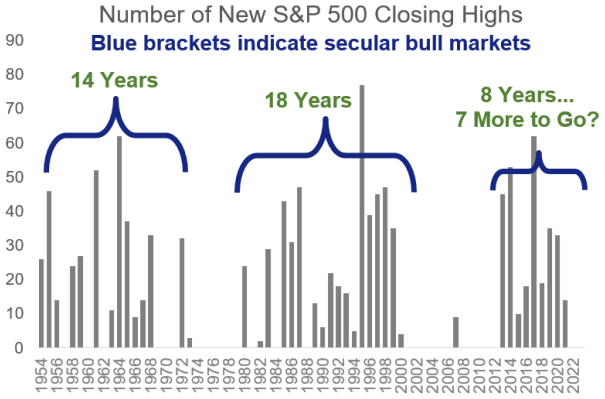
TODD SOHN: As you said, up 75% over the last year, a monumental surge (off the lows). There's two things to know with momentum surges: 1) They are very bullish in the long-term; but 2) We should expect things to be more difficult this year. In Year 2, we tend to see more tepid returns—perhaps more in line with standard historical averages—as well as an increase in volatility. There will be a pullback along the way, and I don't think it's unreasonable to expect a year where you have the economic backdrop outperform the stock market. But the structural case is still there, at least over the next year or so, and that's when the momentum surges typically tend to come back in play and returns come in above-average again.

ROSS: You also looked at stock market performance in the best GDP years, and it's a similar kind of conclusion, right? Where the best years for GDP and the economy aren't always reflected in stock market outperformance that specific year.

TODD: Absolutely. Look at the 1980s or 1950s, where you have great GDP growth but the stock market had seemingly already priced a lot of that in. You had a surges come before and start these new bull markets off the lows, and then the economy catches up. Stocks tend to take a breather to digest all that data, and then eventually a new catalyst helps the structural bull market resume higher. **So that could be a good roadmap for going forward—to expect great news on the economic front, but more tepid market returns in the near-term.**

ROSS: You've done a lot of work on the idea of structural bull markets and how Covid hit just about halfway through one in terms of length. Can you explain that concept and talk about what the pandemic meant for resetting those expectations?

TODD: Over the long-term, markets have these big regime-type changes. And a great way to measure that is how many times a new high is being hit over the course of a year (see chart). So throughout the 1990s, new closing highs were being hit by the week, but in the 2000s, those new highs dried up. These moves happen in ~10–20-year timeframes, and we think we're in one now that started back in 2013. Perhaps a good analogy is that Covid-19 was this market's 1987. A structural bull market started in 1982 and went all the way to 2000, but there was a big crash in 1987. That might be our analogy here. So as long as the market continues to go in this linear upward movement (unlike the sideways movement of say, the 2000s), we're still in a structural bull market. That's the case.



ROSS: I think it's a great framework for how to think about markets right now, which face a more challenging backdrop over the next year or so, but are in the midst of a longer-term structural bull market. Todd, thanks so much for the time and insight.

TODD: Thanks Ross, I appreciate it.

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