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Ellumination Newsletter

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What's up with stocks?

October 31, 2023

Stocks took a big run up in the first half of the year, and now seem to be taking a big run down. So, what's up with stocks? To answer that question, let's get some context.

We have reminded you several times that toward the end of 2022 almost everyone was forecasting the bear market conditions of 2022 would extend into 2023. The only exceptions were Ed Yardeni, of Yardeni Research and Tom Lee, of FSInsight.com. We published our 2023 outlook newsletter on December 23, 2022, in which we said, *"The most optimistic downside target we are seeing is 3600. The lowest target we've seen is from Dan Niles of the Satori Fund. He's talking about 2400 as a downside target, by mid-year. We've seen any number of managers that think we'll see downside targets in the 3000-3400 range, before the market starts to turn back up."* The key message was that most "pundits" thought that stock prices had more downside before they found a bottom and turned back up. Even so, with the exception of Yardeni, no one was calling for stocks to get to the levels they were in July 2023, when the S&P 500 peaked at 4607.

Here are the 2023 year-end price targets that we published in that newsletter. For reference, the S&P 500 closed last Friday at 4119.

Blackrock	3930
Nuveen	4300
Wells Fargo	4200
RBC Capital	4200
JP Morgan	4200
State Street Capital	4000
Yardeni Research	4800
Morgan Stanley	3900

We also know that the rally was built on the strength of "the magnificent 7", including
Microsoft, Netflix, Amazon, Alphabet, Meta, Tesla, Apple. A few other stocks participated in the rally, like Nvidia and Service Now, but for the most part the rest of the S&P 500 went nowhere. That was a clue that the rally was potentially fragile. It had to broaden out to be sustainable. We needed to see upside in the prices of the other 490 stocks in the S&P 500. As of yet that hasn't happened. John Murphy, of Stockcharts.com, reported on Friday, October 27th that 72% of stocks in the S&P 500 were trading below their 200 day moving average. Here's what that looks like:

Source: Stockcharts.com

A stock, or index, trading below this level is in serious corrective mode, if not a bear market. It's possibly a worse indicator that the prices of Tesla, Apple, Amazon, and Alphabet have broken down and are no longer in upward trends. Investor's Business Daily (IBD) reported today that the "magnificent 7" have lost almost $2 trillion in market capitalization since they peaked in July.

The financial press is focused on the fact that the S&P 500 is still up on the year. What most investors don't realize is that it's at the same level it was almost 32 months ago. You could have bought the S&P 500 for the same price in April 2021 that you can today. That has to feel disappointing for most investors. But we shouldn't be surprised. Markets around the world are adjusting to a new interest rate regime. Markets haven't experienced anything like this since the late 1970's and early 1980's.

Here is the chart:

Source: Stockcharts.com

In our December 2022 newsletter we wrote: *"We are reminded that Paul Volker started raising rates in August 1979. Stock prices bounced up and down through 1980, 1981 and 1982. In August 1982 the S&P 500 was at exactly the same level it was in August 1979. It took three years for stock prices to adjust to the new interest rate regime. There was an extreme amount of price volatility, but the broad stock market did not drop below the 1979 low, except for about a month in 1980. If there is a surprise in store for stocks in 2023, it may be that prices are more resilient than consensus opinion is currently expecting."*

In our October 17, 2023 letter we wrote: *"The stock market has proven very resilient this year in the face of rising rates…. It shouldn't be a surprise to anyone that the stock market is taking a breather after its surprising rise in the first half of 2023. It's important for equity investors to remember that both short term and long-term interest rates have returned to more normal levels. The zero-interest rate environment from 2009 through 2022 was the exception, not the norm."*

This correction may or may not be over. Technically and fundamentally there is room for more downside. Within the 4100 to 3800 range there are several "support zones" for the S&P 500. We could be at the bottom today. It may take another month or so. Either way, we should be a lot closer to the end than the beginning. Either way, stock prices are adjusting to the new interest rate regime, the bond market, and the economy that goes with it. It's not time to give up on stocks! Plenty of times this year, in writing and in conversations, we've reminded people that stock prices finished adjusting to Paul Volker's rising rates in August 1982. A new bull market started that lasted until the year 2000 Will history repeat? We don't know, but it sure could rhyme!

All the best,

Paul

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