Bears Back in Charge?

The S&P 500 (SPY) has been sloshing around in the trading range between 4,000 and 4,200 for the past month. However, bulls have gotten 3 straight strikes against them that may point to a looming breakout to the downside. Let's review the growing evidence that bears are likely to come up to bat in the weeks ahead and what that means for our trading plans. Read on below for more.

Let's properly set the scene.

Before the February 1st Fed announcement I shared 4 possible outcomes for the market thereafter. Unfortunately, we devolved into the least savory of these scenarios that I described as follows:

"Scenario 4: Dazed & Confused

This is where the Fed gives mixed signals. Still hawkish for a long time to save face given previous statements. And yet do tip their hat a little to moderating inflation.

This gray area leads to a trading range until investors have more facts in hand. I suspect that 4,000 is the low end with 4,200 at the high end. This comes hand in hand with a ton of volatility as each new headline has investors recalibrate the bull/bear odds."

How accurate this has proved to be. Especially the part about each new headline having folks rethink how bullish or bearish they want to be.

There have been 3 straight strikes against the bulls pushing more investors into the bearish camp. Not just the decline of the market the past 2 sessions. But the clear Risk Off nature of their selections with money flowing back to the most defensive groups (Healthcare, Utilities and Consumer Staples).

Let’s review the box score to account for these 3 strikes and what it means for the evolving market outlook. (This next section was plucked from this recent commentary: Strike 3 for Investors THIS Thursday?)

“…strike 1 against the bulls. That being a MUCH stronger than expected Government Employment situation report showing robust job gains. That sounds great on the surface til you realize it came hand in hand with very persistent wage inflation.

This was precisely what Chairman Powell warned about that previous Wednesday and why the Fed will keep rates higher for longer than the market appreciates. Bulls scoffed at the notion the first time around. However, they did get taken aback when faced with that sticky inflation once more on Friday.

Powell then made it clear the following Tuesday 2/7 at the Economic Forum that this employment reports makes him believe that they may need to push rates higher…or keep them in place for longer to get inflation back to 2% target.

This extended hawkishness is a big STRIKE 1 against the bulls.

.. Strike 2 was pitched this Tuesday (2/14). I am referring to the higher than expected Consumer Price Index (CPI) report coming in at +6.4% vs. 6.2% expectations. This is obviously a far cry from the 2% target of the Fed.

What’s even worse is that month over month inflation was +0.5% which is 6% annualized… Sadly, this far too high month over month tally confirms the Feds notion that the long term battle with inflation is far from over.

The immediate reaction to this news was stocks falling nearly 1% early on the Tuesday session. Yet amazingly bulls fought back once again to a nearly breakeven finish.

These bulls continue to see positive things that I am

not…perhaps they are smoking things I am not as well.”

All the above set the table for the Thursday 2/16 Producer Price Index (PPI) report. Indeed that did prove to be Strike 3 for bulls as it was far too hot leading to an immediate sell off Thursday and Friday.

Let me cement in your minds why this is so bearish.

The recent bull rally was premised on the idea that inflation was coming down faster than expected. This means the Fed was likely to end rate hikes sooner than stated increasing the odds of a soft landing that would usher in the next bull market.

These 3 recent events are a serious strike against that dovish notion. With inflation still this high, then it means the Fed will most likely follow through on its pledge to raise rates to 5% or above…and keep those restrictive policies in place through the end of the year.

When you appreciate how weak the economy is right now, coupled with another 10+ months of hawkish policies, plus 6-12 more months of lagged economic effects on that hawkish regime is a recipe that increases the odds of a recession forming.

Recession = lower corporate earnings = lower stock prices

All the above has me ratcheting up my recession and bear market expectation to about 70-75% (from previous 65%). The main thing holding me back from a higher probability is that employment remains incredibly resilient.

Most of us think about recession as a period of economic contraction. That is only half the story. The key ingredient is that the weakening of the economy brings about job loss and thus increase in the unemployment rate.

That hardship is what helps signify a recession and explains why the negative readings for GDP in the first half of 2022

was not labeled as such. Thus, with employment so strong at this stage of the rate hiking game…then it is still possible it never really worsens, which begets soft landing and end of the bear market.

Yet even as recently as February 1st, Chairman Powell was saying their baseline forecast still calls for unemployment to creep up above 4%. That is not so bad. However, history shows that once the demons of unemployment are unleashed it typically gets much worse than expected.

That's because of this vicious cycle:

Job Loss > Lower Income > Lower Spending > Lower Corporate Earnings > Cost Cutting

And yes, job layoffs are a big part of that cost cutting regime which pushes the rinse and repeat cycle on the above with ever weaker economic readings…and ever greater job loss.

Let's sum it up.

No one knows for sure what will happen in the end. We just need to keep reassessing the likely odds of recession and its follow on effects to stock prices.

The most recent announcements increase the odds of recession and thus bear market. This explains the 2 day sell off with major shift to Risk Off positions.

The information in hand may be enough for stocks to crack below 4,000 once again for the S&P 500 (SPY)…and perhaps back below the all important 200 day moving average at 3,943.

However, I suspect that investors will need more proof that won't be in hand til early March with the next release of ISM Manufacturing, ISM Services and Government Employment Situation. Plus subsequent inflation readings.

I am not saying the bull argument that grew in popularity to

start 2023 is dead. However, the logic of further extending the bear market is becoming all the more likely.

Please consider that in assessing the current structure of your portfolio and if it needs more defensive fine tuning.

What To Do Next?

Discover my brand new "***Stock Trading Plan for 2023***" covering:

- Why 2023 is a "*Jekyll & Hyde*" year for stocks
- How the Bear Market Should Come Back with a Vengeance
- 9 Trades to Profit Now
- 2 Trades with 100%+ Upside Potential as New Bull Emerges
- *And Much More!*

Get It Now! *Stock Trading Plan for 2023 >*

Wishing you a world of investment success!

Steve Reitmeister*…but everyone calls me Reity (pronounced "Righty")*
CEO, StockNews.com and Editor, Reitmeister Total Return

SPY shares were trading at $407.26 per share on Friday afternoon, down $1.02 (-0.25%). Year-to-date, SPY has gained 6.49%, versus a % rise in the benchmark S&P 500 index during the same period.

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Steve is better known to the StockNews audience as “Reity”. Not only is he the CEO of the firm, but he also shares his 40 years of investment experience in the Reitmeister Total Return portfolio. Learn more about Reity’s background, along with links to his most recent articles and stock picks.

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