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COMMENTARY

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Potential Clues to Spotting a Market Bottom

- The broad-based selloff in markets continues.
- Large caps are in a deep correction, while small caps and the Nasdaq are in a bear market.
- Much of the bad news has been priced in and markets could be nearing a bottom.

The stock market is in the midst of the worst selloff since March 2020. Bonds are also down double-digits, resulting in rising volatility across the risk spectrum. The Federal Reserve shifted their language, and policy actions, to a hawkish stance this year, and markets have changed their tune in response. This shift follows an upward trending market from the low in March 2020 through early January this year, when fiscal and monetary policy created a favorable environment for investors and the economy. After another decline on Monday, the S&P 500 now sits 16.8% below the all-time high, and the Russell 2000 (small caps) and Nasdaq (growth and tech stocks) are down 24.7% and 27.6% from their respective highs. Though we don't have a crystal ball, there might be signs that the worst of the selloff is over. Let's take a look at some market metrics for clues when a market bottom might be reached.

- **Buying at the Close** – Momentum can be important. If investors come in before market close and start bidding up stocks, that could potentially change investor psychology for the following day and start a trend.

- **Outperformance of Cyclical and Small Cap Stocks** – When riskier segments of the market start to rebound and outperform, that can be a good sign. Cyclicals outperforming defensive sectors and small caps outperforming large caps could be a signal that investors' confidence is changing.

- **Growth/Technology Stocks Outperform –** Growth and technology stocks have been selling off due to higher valuations (even on a historical basis) and sensitivity to rising bond yields. If bond yields stabilize and growth stocks outperform, that could signal oversold conditions and a reversal.

- **Declining Volatility –** Equity markets stabilizing could mean a bottom is close. As investors become more and more reluctant to sell stocks at low prices, that could be a shift in sentiment.

- **Treasury Yield Curve Steepening** – When the Treasury yield curve inverts, that can be a bad sign. This happens when short-term Treasury yields (two-year Treasury yields) are higher than long-term yields (10-year Treasury yields). When this reverses, it could mean long-term growth prospects are more than short-term prospects. The stock market is forward-looking so this would be viewed favorably.

- **Breadth of Market –** Market breadth remains weak for the major indices. About a third of stocks are above their 200-day moving average for U.S. large caps, and slightly less for mid and small caps. At the bottom of the last two major corrections (2018 and 2020), less than 10% of stocks were above their 200-day moving average.

- **Copper Prices Rising –** China uses a lot of copper in production so rising copper prices could mean rising production. This is a good sign for the global economy because it signals demand for goods and industrial inputs are rising.

- **High Yield Spreads Narrowing –** Fixed income credit markets can give us clues into equity markets. If high yield spreads narrow, this means bond investors are comfortable getting less yield to compensate for added risk of downgrades and defaults.

- **U.S. Dollar Weakening –** The U.S. Dollar is a safe-haven asset and strengthens during bouts of volatility. If the dollar weakens, it could mean risk is back on and investors are comfortable investing in risk assets like stocks.

- **Speculative Investments Rise –** Contrary to the U.S. dollar, speculative assets tend to selloff during bouts of volatility. Cryptocurrencies and NFTs would fall into this category because they lack history, cash flows and earnings. We have already seen NFT sales fall dramatically. If there is a reversal and crypto currencies start to rise in price and NFT sales go up, this could mean investor risk appetite is rising again.

- **Inflation Data** – Later this week there will be a report on inflation data (CPI) which could potentially suggest March year-over-year inflation was the peak. This could be comforting to investors that fear inflation is rising too quickly and can't be contained.

Markets are in a deep correction and investors are looking for clues about when this decline will end. While forecasting the exact bottom is a fool's errand, there are clues to look for. A lot of bad news is now priced into markets and often the best long-term opportunities arise when bearishness is high. Market sentiment is very weak right now, particularly in comparison to last year when volatility was muted. The most overvalued areas of the market have already fallen into a bear market, while overall fundamentals haven't collapsed. Earnings growth is positive, the labor market continues to expand at a strong pace, and there are signs that inflation might be peaking. It is important to work with your Cetera financial professional through this volatile market to ensure your risk tolerance is aligned with your allocation. While we don't recommend timing the market, history has shown that a deep market correction can potentially offer a good long-term entry point, particularly for investors than have remained on the sidelines.

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A diversified portfolio does not assure a profit or protect against loss in a declining market.

The Russell 2000 index is comprised of 2000 small-capitalization companies. It is made up of the bottom two-thirds in company size of the Russell 3000 index.

The S&P 500 is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The Nasdaq Composite Index is a large, broad-based, market-cap-weighted index of more than 2,500 common equities listed on the Nasdaq stock exchange. It is often seen as a stand-in for the technology sector and its performance.