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BANK

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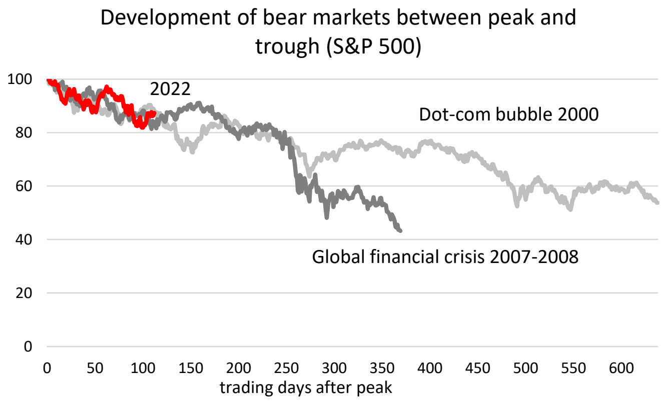
Is a bear market rally looming in the US?

A look at the performance of most stock indices since the beginning of the year dims the mood of many shareholders. The Nasdaq 100 technology index has lost more than 20 percent of its value since then, the broader S&P 500 has lost more than 12 percent and the STOXX Europe 600 is down more than eight percent. Against the backdrop of a cooling economy, high inflation rates and tighter monetary policy, the question arises as to whether the markets have already bottomed out or whether new bottoms will be formed in the further course of the year. At the same time, the question of whether the stock markets are heading for a prolonged bear market is coming up more and more frequently. By definition, a bear market is when stock indices show a loss in value of at least 20 percent compared to the previous high. Thus, the Nasdaq 100 is already in a bear market. How likely is it that the S&P 500 will follow and exceed the technical threshold of 20 percent? Or will the Nasdaq 100 remain the exception due to its high interest rate sensitivity?

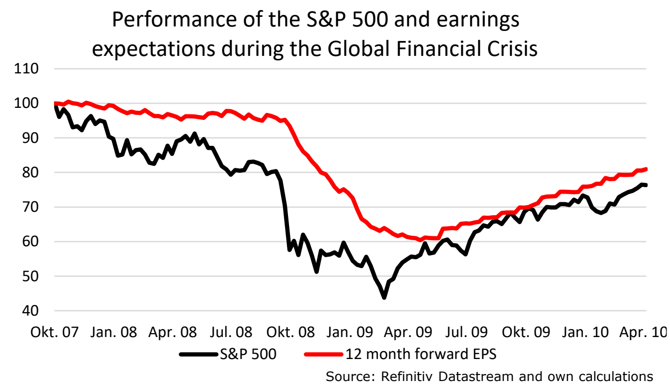
The last major bear market rally in the US was in the context of the global financial crisis (2007-2009). Within 370 trading days, the S&P 500 lost 57 percent compared to its peak on 9 October 2007. As is characteristic of a bear market rally, the phase was not only characterised by a steady downward movement of prices, but also by repeated short-lived price recoveries. It was therefore difficult to recognise a bear market and investors had to be careful not to fall into a bull trap. The good news: a bull market rally followed until 2020 with an annual return of fifteen percent.



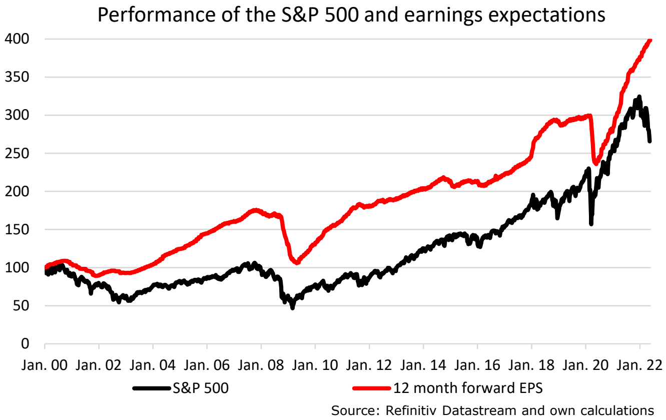
Source: Refinitiv Datastream and own calculations

The bear market rally following the dot-com bubble lasted almost twice as long: the S&P 500 reached its low only after more than 600 trading days and showed a maximum loss of around 46 percent. However, the fact that stock markets can also recover quickly was demonstrated after the outbreak of the Corona pandemic. Although the S&P 500 lost more than thirty percent at the beginning of 2020, it reached its low after only 25 trading days and recovered its losses completely after less than half a year - the expansive monetary policy and stimulating fiscal impulses contributed significantly to this or were ultimately even the only plausible reasons for the rapid recovery.

But what are the prospects for the coming months? What would suggest that the stabilisation of the last few weeks is the beginning of a longer-term and sustainable recovery on the markets? Leaving aside psychological factors and approaching this topic via a fundamentally oriented traditional discounted cash flow model, earnings expectations play the central role in the projection of share prices alongside the discount factor. If analysts expect higher profits from the company, they adjust their price targets upwards accordingly. On the other hand, rising interest rates reduce the present value of future profits and lead to a downward adjustment of the share price. In the past, earnings expectations in the form of analysts' estimates of earnings per share for the coming twelve months and share prices often moved in tandem. At times, however, earnings expectations were adjusted with a time lag. For example, analysts only adjusted their earnings expectations after a change in the share price. This correlation is particularly striking during the global financial crisis: although share prices had already fallen by 20% at the peak in the context of the turmoil on the financial markets due to an increasingly obvious subprime crisis, analysts did not adjust their earnings estimates at first. Analysts only adjusted their earnings estimates after the S&P 500 experienced another sharp and abrupt price slide in October 2008.



At the current margin, a striking discrepancy between the development of earnings expectations and the S&P 500 can again be observed. While share prices have come under pressure since the beginning of the year due to the rise in interest rates, among other things, earnings expectations have remained true to their trend and have risen continuously. One possible reason for the rise in earnings expectations is the increase in inflation. A simplified example makes this clear: with a turnover of €100 and costs of €40, the profit of a company is €60. If input costs increase by 50% to €60 and the company manages to keep its profit margin constant (it passes on the increased costs 1:1), turnover would rise to €150 and profit to €90. However, it is unlikely that it will be possible to pass on rising input prices completely over a longer period of time - accordingly, profits and profit margins will eventually shrink again. In addition, a cooling economy is likely to cloud the profit outlook, at least temporarily.



Now it is getting exciting: The question arises whether stock markets still have room for significant price increases in this environment. After all, prices have been falling in recent months despite rising profits. Why should prices now rise when profits are falling, especially since in view of the turnaround in interest rates in the USA and the euro area, the policy of "cheap money" is over and less impetus can be expected from fiscal policy in the future? It should also not be forgotten that Jerome Powell, as president of the US Federal Reserve, has signaled that he cannot guarantee a "soft landing" in the course of monetary tightening and that if necessary he will raise the key interest rate above the level of the natural interest rate. This definitely reduces the upward potential of share prices. Whether the S&P 500 will slide into a bear market because of this is nevertheless difficult to assess. But this much is certain: especially interest-sensitive and highly valued (unprofitable) growth stocks are susceptible to further price declines. It is therefore advisable, especially for risk-averse investors, to keep the portfolio broad and initially rather defensive. In addition, investors should keep in mind that, especially in the current market environment, any price recovery could only be the beginning of a bear market rally.

Market data

Stock marktes	As of 10.06.2022 07:48	Change versus 25.05.2022 -1 week	29.04.2022 -1 month	28.02.2022 -3 months	31.05.2021 -1 year	31.12.2021 YTD
Dow Jones	32273	0,5%	-2,1%	-4,8%	-6,5%	-11,2%
S&P 500	4018	1,0%	-2,8%	-8,1%	-4,4%	-15,7%
Nasdaq	11754	2,8%	-4,7%	-14,5%	-14,5%	-24,9%
DAX	14199	1,4%	0,7%	-1,8%	-7,9%	-10,6%
MDAX	29650	1,9%	-1,5%	-7,0%	-10,7%	-15,6%
TecDAX	3110	1,7%	-0,6%	-3,9%	-8,9%	-20,7%
EuroStoxx 50	3724	1,3%	-2,1%	-5,1%	-7,8%	-13,4%
Stoxx 50	3600	0,0%	-3,4%	-1,2%	4,7%	-5,7%
SMI (Swiss Market Index)	11322	-1,5%	-6,6%	-5,5%	-0,4%	-12,1%
Nikkei 225	28247	5,9%	5,2%	6,5%	-2,1%	-1,9%
Brasilien BOVESPA	107094	-3,2%	-0,7%	-5,3%	-15,2%	2,2%
Russland RTS	1213	-2,1%	12,1%	29,4%	-24,1%	-24,0%
Indien BSE 30	54617	1,6%	-4,3%	-2,9%	5,2%	-6,2%
China CSI 300	4204	5,5%	4,7%	-8,3%	-21,2%	-14,9%
MSCI Welt	2722	0,8%	-2,6%	-8,6%	-8,5%	-15,8%
MSCI Emerging Markets	1067	4,7%	-0,8%	-8,9%	-22,5%	-13,4%
Bond markets						
Bund-Future	147,80	-612	-579	-1924	-2214	-2357
Bobl-Future	123,06	-448	-412	-880	-1166	-1018
Schatz-Future	108,68	-171	-146	-331	-336	-335
3 Monats Euribor	-0,30	29	28	28	24	29
3M Euribor Future, Dec 2017	1,19	44	50	0	172	2
3 Monats $ Libor	1,61	6	28	111	148	140
Fed Funds Future, Dec 2017	2,79	24	5	0	271	2
10 year US Treasuries	3,05	30	17	121	146	155
10 year Bunds	1,44	48	54	132	162	162
10 year JGB	0,25	4	3	7	17	18
10 year Swiss Government	1,10	37	26	84	125	123
US Treas 10Y Performance	619,40	-0,3%	0,7%	-8,5%	-9,3%	-11,3%
Bund 10Y Performance	588,91	-1,6%	-1,7%	-8,5%	-11,0%	-11,1%
REX Performance Index	455,45	-1,8%	-1,6%	-5,4%	-7,4%	-7,2%
US mortgage rate	0,00	0	0	0	0	0
IBOXX AA, €	2,07	12	26	99	177	159
IBOXX BBB, €	3,00	8	34	121	227	212
ML US High Yield	7,20	-36	16	137	243	230
Convertible Bonds, Exane 25	6834	0,0%	-5,3%	-9,3%	-17,8%	-16,6%
Commodities						
MG Base Metal Index	475,20	2,5%	-5,5%	-5,8%	7,7%	3,0%
Crude oil Brent	122,47	7,2%	13,6%	21,0%	75,7%	56,2%
Gold	1844,03	-0,3%	-3,4%	-3,1%	-3,3%	1,2%
Silver	21,76	-0,6%	-5,8%	-10,2%	-21,9%	-6,5%
Aluminium	2757,75	-3,1%	-9,1%	-18,6%	12,2%	-1,7%
Copper	9445,50	0,8%	-3,3%	-4,8%	-7,8%	-3,0%
Iron ore	143,63	7,8%	-4,7%	1,2%	-30,2%	27,7%
Freight rates Baltic Dry Index	2342	-25,1%	-2,6%	14,8%	-9,8%	5,6%
Currencies						
EUR/ USD	1,0638	-0,2%	0,9%	-5,0%	-12,8%	-6,1%
EUR/ GBP	0,8497	-0,2%	1,1%	1,5%	-1,2%	1,2%
EUR/ JPY	142,27	5,1%	3,8%	10,0%	6,3%	9,1%
EUR/ CHF	1,0409	1,4%	1,8%	0,7%	-5,2%	0,8%
USD/ CNY	6,6807	-0,2%	1,1%	5,9%	4,9%	5,1%
USD/ JPY	128,70	1,1%	-0,9%	11,9%	17,5%	11,8%
USD/ GBP	0,80	0,2%	0,3%	7,2%	13,6%	8,2%

Source: Refinitiv Datastream

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