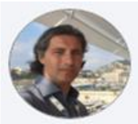
August 19, 2022

GAV S&P 500 Outlook Report



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Long-term S&P 500 Outlook

Very Bearish	Bearish	Neutral	Bullish	Very Bullish

Longer-term, stock market prices will be driven mainly by the unfolding trend of de-globalization, which will cause a stagflationary environment. Inflation will continue to be elevated due to supply-chain issues and commodity shortages, while growth will be lower due to less trade. The recessions will be more frequent. Thus, longer-term, the market will be volatile with the periods of selloffs and rallies. Monetary and fiscal policy stimuli will be the primary positive catalysts for the upside. Thus, this is not a buy-and-hold environment.

Assessment of the probability of a sharp selloff (>10% correction and >20% bear market)

- Phase 1: Probability of the Fed-induced Liquidity Shock Sell-off (**Completed**)

The Phase 1 (of the full bear market) usually occurs when the market expects a very aggressive monetary policy tightening (2Y-FF), in the presence of overvalued market, and/or other speculative bubbles. We have been in the Phase 1 selloff from Jan 1 to June 17th (-24%), as the Fed fell behind the rising inflation. The market bottomed as the peak Fed hawkishness was reached on June 16th (3.66% FF for 2022). The PE ratio decreased from 37 to 21.

Monetary policy expectations						
Front	Jan 2023	Jan 2024	High	First cut	Low	Jan 27 -long term
2.33	3.53	3.30	3.68 Apr 23	3.39 Nov 23	2.95Jan25	3.30
2.33%	3.53	3.22	3.66 Apr 23	3.41 Oct 23	2.84Jan25	3.20 last week
QE ended in March. QT starting in June – June-Aug $47.5 bill/month, after $95bill/month						

BE Inflation expectations			
	Nominal Yield (*last week*)	Real Rate	BE Inflation Expectations
10Y	2.97%(2.83%)	0.41%(0.35%)	2.56%(2.48%) – 3.02% peak Apr 21st

The Fed-induced liquidity shock selloff now depends on what happens in 2023 - Jan 2024 contracts peaked at 3.80 on June 15th. The Fed is expected to stop hiking by Apr 23 and cut by Nov 23. Thus, the Phase 1 selloff is likely completed, and the attention turns to the Phase 2 selloff.

- Phase 2: Probability of an Imminent Recession Sell-off (**Still Low**)

The Phase 2 selloff of the full bear market happens when the Fed's tightening causes a recession, which causes downgrade in earnings and contracts the valuations. Recession can also happen due to the triggers unrelated to the Fed. The 10Y-2Y spread reached the -0.40 level on Aug 5 (lowest -0.48), and first inverted in March. Thus, the probability of a recession within 12-24months is very high. However, the 10Y-3mo is still positive near 0%, but it's expected to invert in Sep 2022. The labor market is still strong (3.5% unemployment rate). However, the Q1 and Q2 of 2022 have been negative due to the slowdown in business investment – so the recession could technically be here already. The Fed's first cut expected in Nov 2023. The sharp increase in initial clams could trigger the Phase 2 selloff. Housing market is slowing down. However, still not enough evidence of an immediate recessionary selloff.

12-Month Recession probability		
10Y-2Y spread	-0.26% (-0.41%)	Inverted – Inverted week of March 28th –0.48% peak
10Y-3mo spread	0.31% (0.20%)	Widened – an imminent recession still not expected
2Y-3mo spread	0.58% (0.72%)	Positive – Fed still behind

- Phase 3: Probability of the Credit Risk Sell-off (**Low**)

The Phase 3 of the full bear market, or the credit risk selloff happens if during a recession corporate and personal bankruptcies increase and cause forced selling and deleveraging. The BBB-10Y credit spread is currently at the low-modest level below 2.50%. Thus, the credit risk selloff is not expected yet. The housing market is slowing down, but no evidence of sharpy falling housing prices.

Credit risk – Moderate/Low – Phase 3 selloff – not yet expected			
Credit risk	BBB-10Y	2.24% (2.29%)	Decreased – (still modest)
Housing	Case-Schiller	21.2% (20.1)% yoy	Highest increase ever – bubble?
Volatility	VIX	20.6	Decreased – right at the 20 level.

Tactical S&P 500 outlook (near-term)

The Phase 1 selloff was completed and the relief bounce (bear market rally) reached the key technical resistance at 200dma. No solid evidence to expect the Phase 2 recessionary selloff yet.

The Phase 2 selloff perquisites: 1) a deep 10y-3mo inversion, and 2) strong evidence that labor market is weakening, Until then, the bear market rally could continue. At the same time, the liquidity is still low, and thus, the probability of a low-volume volatility (in both direction) is high.

- **Tactical Strategies**

Theme 1: No evidence of a recession and the Fed slows the hikes – long the bear market rally.

- Strategy 1: Long the 200dma breakout. Target 4600:
- Strategy 2: Long the 100dma support. Target 200dma.

Theme 2: Phase 2 selloff trade: an imminent recession – the bear market continues

- Strategy 3: Short the 200dma resistance
- Strategy 4: Short the 100dma breakdown