FVCM

U.S. MARKET REPORT

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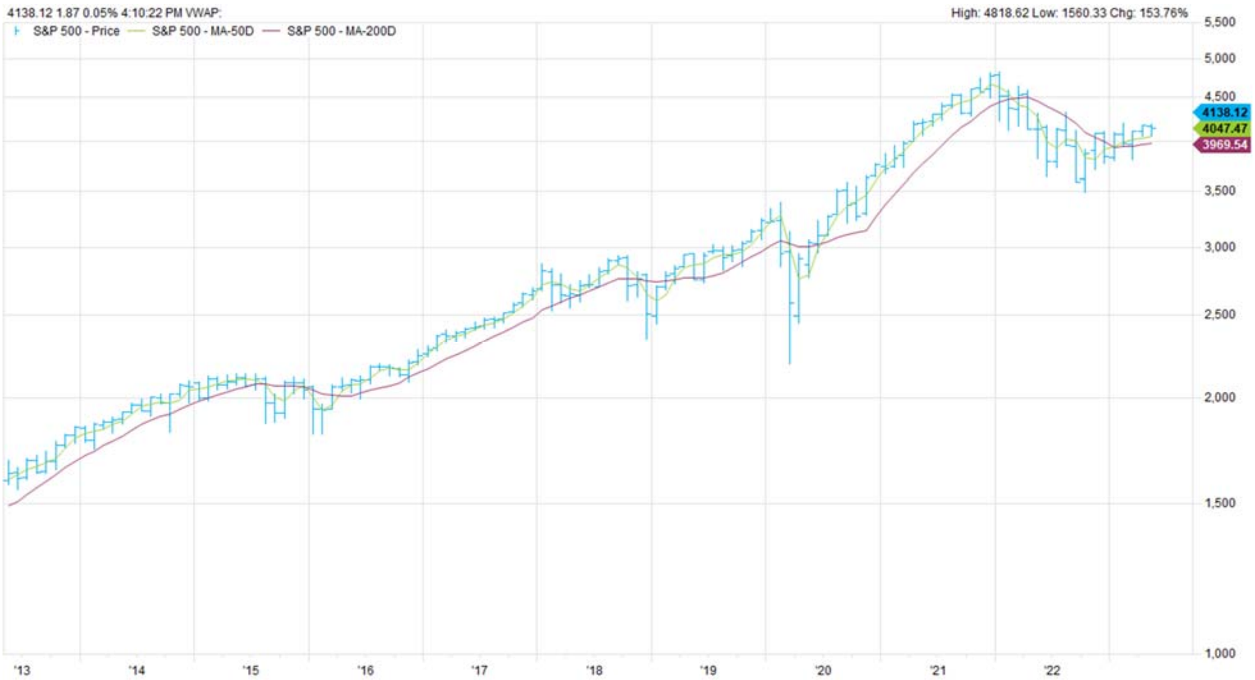
S&P 500



Known Unknown: S&P 500 (SPX) Cyclical Trough

Table 1

Recession Start	SPX Low Month	Month since Start Recession
1973.12	1974.09	9
1980.02	Market continued decline	
1981.08	1982.07	11
1990.08	1990.10	2
2001.04	2002.09	17
2008.01	2009.02	13
2020.03	2020.03	0
Averages		9

Source: Federal Reserve

There remains broad discussion, and uncertainty, as to whether the S&P 500 has already set a bottom in this cycle, or whether another steep decline in stock prices lies ahead. We believe that the bottom likely has been set, but that opinion is controversial. The S&P 500 reached a cyclical peak on January 3, 2022 closing at 4,797. The 25% decline in stock prices that followed took the index down to a low of 3577 on October 12, 2022. That drop in stock prices is in line with the 30% average decline experienced over the past eight bear markets since 1972. Nonetheless, many are arguing that the S&P 500 will not truly hit bottom until sometime after a recession has begun: As seen in Table 1, with the exception of the market bottom in March 2020, which was right at the start of the short 2 month "Covid Recession," all market bottoms since the 1970s have *followed* the start of a recession.

Could it be that a recession is underway and the SPX has already bottomed? Recent recessions have started within an average of 6 months after an SPX peak (see table below) and this bear market is already 16 months old. Not so coincidentally, S&P Global reports that earnings for the S&P 500, according to conservative Generally Accepted Accounting Principles (GAAP), also peaked in the fourth quarter of 2021, already 16 months ago. Keep in mind that many of the earnings figures published by brokerage houses, which have shown earnings continuing to rise, are based on "operating earnings." Such operating earnings exclude many costs that company managers or sell-side analysts declare as unusual or nonrecurring. The exclusion of these costs are arbitrary and, hence, the GAAP earnings should be considered more reliable. The "operating earnings" shown in Table 3, were calculated by S&P and are more conservative than typically shown by others, but obviously not as conservative as the GAAP numbers. Notice also that the decline in earnings has occurred despite higher sales. This reflects the disproportionately large jump in producer price inflation and a squeeze in profit margins. With stock prices and GAAP earnings down for 16 months, the question is whether a recession may already be underway or near. In the U.S., recessions are declared and dated by an organization called the National Bureau of Economic Research (NBER).

Table 2

SPX Peak Month	# Mos SPX Peak before Recession	Recession Start
1972.12	12	1973.12
No Related Peak		1980.02
1981.03	5	1981.08
1990.05	3	1990.08
2000.08	8	2001.04
2007.10	3	2008.01
2019.12	3	2020.03
2022.01		Unknown
	6	

Source: Federal Reserve

Table 3 S&P 500 Sales & Earnings

	Sales	S&P Oper. Earnings	Special Charges	GAAP Net Earnings
2020.03	332.59	19.50	7.62	11.88
2020.06	315.61	26.79	8.96	17.83
2020.09	346.71	37.90	4.92	32.98
2020.12	367.48	38.18	6.74	31.44
2021.03	364.05	47.41	1.46	45.95
2021.06	384.51	52.05	3.66	48.39
2021.09	395.07	52.02	2.43	49.59
2021.12	423.17	56.73	2.79	53.94
2022.03	413.73	49.36	3.37	45.99
2022.06	431.39	46.87	4.13	42.74
2022.09	446.33	50.35	5.94	44.41
2022.12	461.40	50.37	10.76	39.61

Source: S&P Global

Historically, there have been delays between the start of recessions and when the NBER finally declares a recession. For example, the Great Recession was already underway in January 2008 but the NBER did not officially announce a recession until December 2008. Similarly, the NBER did not officially declare the 2001 recession until November of that year, some eight months after the start. These delays are inevitable because most economic data are derived from household and business surveys which go through a series of revisions before the final data is realized. This issue may now be even more problematic than it has been in the past. In December 2022, a report from within the Bureau of Labor Statistics showed that response rates to many of the major government surveys had declined, especially since the start of the pandemic.

In summary, this business cycle has been unusual on many levels. We would not rule out the possibility that the stock market has already set a cycle low and will trend higher, albeit along with considerable volatility. It is true that stock market bottoms have historically followed recessions, not led recessions. This is because recessions lead to lower corporate profits. As we have shown, contrary to popular belief, corporate profits have been falling for more than a year due to cost inflation and narrower profit margins. As data is revised, we may discover that a recession has already started. Furthermore, material costs and other producer prices are now falling or at least not rising as fast as sales. Profit margins may be nearing a bottom and could rebound in the quarters ahead. A quarter point increase in interest rates was implemented last week, but if data revisions lead the Federal Reserve to halt future interest rate increases, that would be another wind to the market's back. This period is unlike any other and we need to consider a wider range of possibilities and recognize the unknowns.

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