Thackray Report

Are Investors Partying Before the Hurricane?

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On Wednesday June 1, 2022, JPMorgan Chase CEO Jamie Dimon warned that "You know, I said there's storm clouds but I'm going to change it … it's a hurricane."

Are investors partying before a hurricane?

Hurricane parties are a real thing...in Florida. Groups of people get together and start partying in a boarded up location before the hurricane arrives. Ignoring all weather and police warnings, they tempt fate. If the hurricane looks like it is going to be worse than expected, the partiers head inland as quickly as possible. Of course, there are some that stay behind and keep partying and hopefully make it out the other side alive.

It is unusual for a CEO of a major bank to be so candid about the prospects for the economy, warning of an economic hurricane. It is not just Dimon that is prognosticating trouble ahead. On Thursday June 2, 2022, Goldman Sachs President John Waldron echoed Dimon's concerns. On the same day, Elon Musk stated that he had a "super bad felling" about the economy and announced that Tesla would freeze hiring and cut its workforce by 10%.

The normal modus operandi is for Wall Street to keep everyone partying (investing) as long as possible. Famously, in 2007 before the GFC, Chuck Prince, CEO of Citigroup said "When the music stops, in terms of liquidity, things will be complicated," Prince said. "But as long as the music is playing, you've got to get up and dance."

Should investors keep dancing and ignore the litany of economic headwinds that are going to make it difficult for the markets to move substantially higher?

♦ *High and declining profit margins- declining profit margins are going to put downward pressure on earnings*

♦ *Rising interest and mortgage rates - less liquidity for consumers using their homes as ATMs.*

♦ *Rising credit card debt - consumers are running up credit card balances that are going to be hard to pay-off with higher interest rates*

♦ *Falling house prices- home owners are less likely to spend money when their net worth drops and have a reduced capacity to withdraw money from their equity*

♦ *Federal Reserve just getting started on its tight monetary policy- making it more expensive* *to borrow and companies to reduce their spending plans*

♦ *High inflation- consumers are starting to allocate spending from discretionary items to food and other staple items as costs rise*

♦ *and other indicators*

Investors are relying on "Buy The Dip" (BTD) to work once again... but it might be broken

Buy the dip has worked well since 2009. When the stock market dropped, investors piled into the stock market. It worked time after time. The Federal Reserve was on standby ready to prop up the markets. It seemed like it might not work in March 2020, but the Federal Reserve and government made it clear that they would not let the markets stay low for long. Times have changed. The Federal Reserve has communicated that fighting inflation is more important at this point than supporting the markets, at least for now.

The stock market often bounces after it has fallen 10%. The media typically writes about how the stock market is on sale and how often a 10% drop is a good buying opportunity. As a result, the market often rallies at after it has fallen 10%. Sometimes, it heads lower to the 20% threshold. The process is repeated. The media writes about how often a drop of 20% is a great buying opportunity. As a result, the market tends to bounce at the 20% level.

So where are we now? The S&P 500 peak was on January 3, at 4796.56 on a close basis. After it dropped 10% from its peak on March 1, it attempted a rally higher, but it failed. It was not an instantaneous fail, as the S&P 500 oscillated around the 10% drop level. When it broke decisively below the 10% drop level on April 22 it headed to the 20% drop level. On an intra-day basis, the S&P 500 managed to get below the 20% level on May 20, but closed above the level. It has since tried to mount a rally and has managed to stay above the 20% drop level.

Is the 20% drop level a true bottom or will we repeat the break of the 10% drop level? It is possible that the market could chop back and forth in between the 10% and 20% drop level. Recently, we have seen a bounce in the markets around May month end. Investors should be careful in interpreting this bounce as a trend. The stock market often rallies around month end, especially if it has corrected during the month. I have written about the end-of-the-month phenomenon in my books and articles. The long-term seasonal trend for the S&P 500 in May played out in the market this year. The S&P 500 rallied in the first few days of the month, corrected into late in the month and then rallied into early into early June.

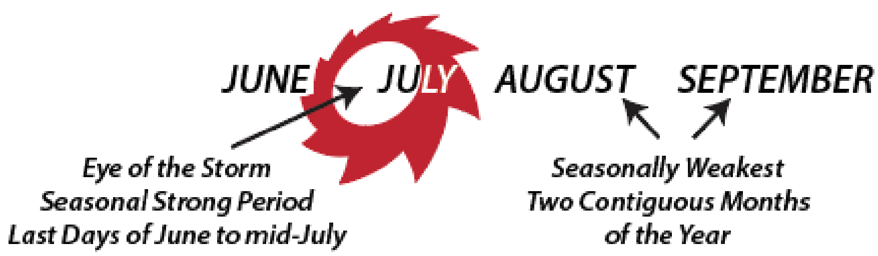
On a seasonal basis, June tends to be negative month, particularly in mid-term election years. With so much going on in news with rising inflation and the Russia-Ukraine war, I believe that the worries over the upcoming election have been delayed and will likely play out in August and September.

Good News Ahead - Eye of the Storm

There is good seasonal news for the stock market coming up in late June. The stock market has a strong tendency to rally from late June into mid-July, ahead of Q3 earnings season. Seasonal trends do not always play out, but a correction into June month end, could present a good short-term buying opportunity later this month.

The potential seasonal rally from late June into mid-July, could be the "eye in the hurricane." I have written about this seasonal tendency many times in my books and articles. The stock market tends to rally at this time as investors position themselves in the market before Q2 earnings season which starts mid-July. This trend has been strong over time. In my *Thackray's 2022 Investors Guide*, I illustrate that the S&P 500 has on average performed well over the long-term from late June into mid-July. The trend has been persistent over time in recent years (for more details, see *Thackray's 2022 Investor's Guide*). Once earnings season gets underway, the stock market tends to falter and sets up for the worst two contiguous months of the year (August and September).

Perhaps the best way to think of the upcoming earnings trade is to see it potentially as the "eye of the storm." An opportunity that exists in volatile markets that have performed poorly and have a tendency to perform poorly after mid-July. Investors should be careful as the period following the "eye of the storm," tends to be weak.



A lot could go wrong and right for the markets this summer. The stock market has many headwinds to fight. Over the last twelve years, the Federal Reserve has been extremely supportive of the stock market, pumping in liquidity when the market faltered. Most of the previous quantitative actions were either announced or leaked in the weak seasonal period for the stock market from May to October. This created a distortion helping to support the stock market when it is traditionally weak. This time is different. The Federal Reserve has announced that its primary focus is to fight inflation (that it helped cause). There is a lot of discussion in the media about when the Federal Reserve may pivot, but it will probably remain in its aggressive stance against inflation in the short-term over the summer months. In other words, it is highly unlikely that the Federal Reserve will rescue the stock market in the short-term. Investors should expect a volatile summer and perhaps hurricane force winds upsetting the market. There will be opportunities for the more nimble traders, but clouds are gathering on the horizon.

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