Research
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US Equity market has entered a bear market territory — how low can the markets fall in 2022???

On May 20th, the S&P 500 crossed the bear market threshold of a 20 percent decline from its peak — what is next? Nasdaq Composite Index has been in the bear market territory (-28% YTD) in 2022 for a while.

How low can the markets fall in 2022?

The previous 19 bear markets in the US had an average decline of 39%. Today's combination of unfortunate factors will make a difference. An orgy of speculation in 2H 2021 (historically high equity valuations, historical top in bullish sentiment, and record margin debt relative to GDP, which was higher than during the 2000 and 2007 market tops) was confronted by a "once in a decade" shift in the monetary policy of major central banks and inflation getting out of control. Uncontrolled money printing by Fed and ECB has been postponing the consequences of the disbalances in the economy. At the same time, it created bubbles in many asset classes.

At the moment, the markets are pricing a scenario that rising rates and reducing Fed's balance sheet make the soft landing in the US impossible, and a severe recession is the most likely outcome. Today's situation is different from all past business cycles. Our primary assumption in the investment strategy since 2017 was: We live in a world no one has ever lived in before. Therefore, it is impossible to predict if the market went down 1/3, 1/2 or 2/3. There will be a few "bear market rallies" — powerful pullbacks on the way down. But in equities, the investors must be aligned with the main trend. And the main trend today is bearish.

What does a 20 percent decline in S&P 500 mean for the equity markets?

A 20% decline is a symbolic marker of investors' deep pessimism. The politicians who run the investment banks and chair the investment committees of the largest institutional investors usually instruct investment professionals to sell equities **after** the market is down 20%+. We should expect this to happen in the coming weeks or months, further increasing the pace of markets' fall. This has happened in 4Q 2008 and March of 2020. I remember a prominent hedge fund dumping EM stocks at the end of 2008 at a price 10–20% below the bid just because its largest investor decided "to decrease an exposure to EM equities" …. after EM equities were already down 30% on average. Conclusion: we are just beginning the "forced liquidation" period. Capitulation is nowhere near. Equities have a long way to go down.

But there is always a way to make money in any market conditions. And the best way always has been buying unpopular, "out of the favour," bitten down assets. In the following publication, I will share some views on the various segments of equity markets, which will deliver outperformance in the next business cycle.

What do you think? I would love to hear feedback from friends and colleagues.

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