Bear Market Realities

Stocks moved steadily lower over the course of the day as the S&P 500 threatened to confirm via the conventional definition (a 20% decline on a closing basis) what has been increasingly obvious elsewhere in recent days: a cyclical bear market has emerged in the wake of the February peak.

While the S&P 500 has narrowly skirted this conventional definition since the March 2009 lows, from our perspective we have now entered the fourth cyclical bear market endured over those 11 years (we consider the declines in 2011, 2015/16, and 2018 to be cyclical bear markets). Those previous three bear markets came in the context of an ongoing economic expansion and were historically shallow and relatively short-lived. Over the past 100 years, cyclical bear markets (as defined by Ned Davis Research) that emerge outside of economic recessions have seen a median decline of 25%. If that applies to the current case, we may have already experienced the bulk of the price decline in this bear market (the S&P 500 closed today 19% below its February peak).

In terms of sentiment and valuations, bear markets tend not just to relieve upside excesses but leave in their wake downside excesses. While we have seen some evidence of near-term pessimism building, this week's data from Investors Intelligence still shows more bulls than bears and is not consistent with a bear market low in pessimism. Even if price declines slow down and volatility ebbs, it may take some time for pessimism to build. We will have comments (with charts and tables) on bear market behavior in tomorrow’s weekly Market Commentary.

The unknown (and at this point un-measurable) impact of the spread of the coronavirus is challenging the outlook for the economy. As we have mentioned in the past, the good news is that the economy was showing signs of improving growth to the outbreak. Our Weight of the Evidence remains neutral at this point and so expecting a more significant drawdown in price would be premature at this point. If the weight of the evidence deteriorates further, it may be wise for active investors to take more defensive action.

For the day, the S&P 500 closed well off of its worst levels but still closed down nearly 5% and at its lowest level since February 2019. Encouragingly, there was some evidence that the type of indiscriminate selling associated with preliminary lows had emerged. Downside volume versus upside volume moderated to just 25-to-1 at the close but mid-day selling pressure sent the TRIN soaring well above 2, before closing at a more pedestrian 1.6. While breadth overall was poor, the number of individual stocks making new 52-week lows on the NYSE and NASDAQ did not exceed what was seen on Monday.

**Bottom line:** Bear market labels make great headlines and allow for some not always alarming historical context. While longer-term sentiment/valuation may need to unwind further, some evidence of panic today points to possible peak in near-term volatility. With the weight of the evidence still neutral, patience on the part of investors is the recommended strategy.
Appendix – Important Disclosures and Analyst Certification

Analyst Certification

The senior research analyst(s) certifies that the views expressed in this research report and/or financial model accurately reflect such senior analyst's personal views about the subject securities or issuers and that no part of his or her compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained in the research report.

Disclaimers

This is not a complete analysis of every material fact regarding any company, industry or security. The opinions expressed here reflect our judgment at this date and are subject to change. The information has been obtained from sources we consider to be reliable, but we cannot guarantee the accuracy.

ADDITIONAL INFORMATION ON COMPANIES MENTIONED HEREIN IS AVAILABLE UPON REQUEST

The Dow Jones Industrial Average, S&P 500, S&P 400 and Russell 2000 and any other indices mentioned are unmanaged common stock indices used to measure and report performance of various sectors of the stock market; direct investment in indices is not available. Baird is exempt from the requirement to hold an Australian financial services license. Baird is regulated by the United States Securities and Exchange Commission, FINRA, and various other self‐regulatory organizations and those laws and regulations may differ from Australian laws. This report has been prepared in accordance with the laws and regulations governing United States broker‐dealers and not Australian laws.

United Kingdom ("UK") disclosure requirements for the purpose of distributing this research into the UK and other countries for which Robert W. Baird Limited holds a MiFID passport.

The contents of this report may contain an "investment recommendation", as defined by the Market Abuse Regulation EU No 596/2014 ("MAR"). This report does not contain a "personal recommendation" or "investment advice", as defined by the Market in Financial Instruments Directive 2014/65/EU ("MiFID"). Please therefore be aware of the important disclosures outlined below. Unless otherwise stated, this report was completed and first disseminated at the date and time provided on the timestamp of the report. If you would like further information on dissemination times, please contact us. The views contained in this report: (i) do not necessarily correspond to, and may differ from, the views of Robert W. Baird Limited or any other entity within the Baird Group, in particular Robert W. Baird & Co. Incorporated; and (ii) may differ from the views of another individual of Robert W. Baird Limited.

This material is distributed in the UK and the European Economic Area ("EEA") by Robert W. Baird Limited, which has an office at Finsbury Circus House, 15 Finsbury Circus, London EC2M 7EB and is authorized and regulated by the Financial Conduct Authority ("FCA") in the UK.

For the purposes of the FCA requirements, this investment research report is classified as investment research and is objective. This material is only directed at and is only made available to persons in the EEA who would satisfy the criteria of being "Professional" investors under MiFID and to persons in the UK falling within Articles 19, 38, 47, and 49 of the Financial Services and Markets Act of 2000 (Financial Promotion) Order 2005 (all such persons being referred to as "relevant persons"). Accordingly, this document is intended only for persons regarded as investment professionals (or equivalent) and is not to be distributed to or passed onto any other person (such as persons who would be classified as Retail clients under MiFID).

All substantially material sources of the information contained in this report are disclosed. All sources of information in this report are reliable, but where there is any doubt as to reliability of a particular source, this is clearly indicated. There is no intention to update this report in future. Where, for any reason, an update is made, this will be made clear in writing on the research report. Such instances will be occasional only.
Investment involves risk. The price of securities may fluctuate and past performance is not indicative of future results. Any recommendation contained in the research report does not have regard to the specific investment objectives, financial situation and the particular needs of any individuals. You are advised to exercise caution in relation to the research report. If you are in any doubt about any of the contents of this document, you should obtain independent professional advice.

Robert W. Baird Limited and Robert W. Baird & Co. Incorporated have in place organisational and administrative arrangements for the prevention, avoidance, and disclosure of conflicts of interest with respect to research recommendations. Robert W. Baird Limited’s Conflicts of Interest Policy, available here, outlines the approach Robert W. Baird Limited takes in relation to conflicts of interest and includes detail as to its procedures in place to identify, manage and control conflicts of interest. Robert W. Baird Limited and or one of its affiliates may be party to an agreement with the issuer that is the subject of this report relating to the provision of services of investment firms. Robert W. Baird & Co. Incorporated’s policies and procedures are designed to identify and effectively manage conflicts of interest related to the preparation and content of research reports and to promote objective and reliable research that reflects the truly held opinions of research analysts. Robert W. Baird & Co. Incorporated’s research analysts certify on a quarterly basis that such research reports accurately reflect their personal views.

This material is strictly confidential to the recipient and not intended for persons in jurisdictions where the distribution or publication of this research report is not permitted under the applicable laws or regulations of such jurisdiction.

Robert W. Baird Limited is exempt from the requirement to hold an Australian financial services license and is regulated by the FCA under UK laws, which may differ from Australian laws. As such, this document has not been prepared in accordance with Australian laws.

Copyright 2020 Robert W. Baird & Co. Incorporated