JW S03E14 Sam Stovall

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SPEAKERS
Sam Stovall, Pat Bolland

Pat Bolland 00:15
Hi, welcome to the Justword podcast once again... you know, it hasn't been a really good American stock market the last month or so. And so I thought we'd get an expert to come in join us ... Sam Stoval is with CFRA research, where he's the chief investment strategist. And he joins ... Sam, I haven't seen you in so long. Great to see you again.

Sam Stovall 01:00
Good to see you, Pat, you haven't aged a bit.

Pat Bolland 01:04
Thank you. And the same back at you, man. Listen, before we get into what's happening with the American stock market. I do want to ask you one question. It's almost personal, because I know you're so associated to the Standard and Poor's 500 Index. But whenever people talk about the American stock market, they talk about the Dow Jones, the Dow Jones is only 30 stocks, why don't people give the respect to, or do you think they do give the respect to the S&P 500?

Sam Stovall 01:30
Well, Pat, I think it depends on who you're talking to. Those in the industry will typically refer to either the S&P or the NASDAQ as the primary benchmarks of interest. However, if you're dealing with your general news, and they move to the business section, then they'll mention the Dow for a couple of reasons. I think first off, it's the sentimental favorite, it was initiated back in the mid 1890s. So it's been around a lot longer than the s&p 500, which was started in 1957, even though it borrowed an index that was started in the early 1920s. And also, let's face it, that's about a 93% correlation between the S&P and the Dow. Okay,

Pat Bolland 02:15
so it gets enough respect where it needs to be respected, I guess, talk to me about what's happening in the American market. Because when you think about what's happened in the last six, eight weeks, even, you know, UAW strike,, student loans having to get repaid, the debt ceiling was just addressed

recently, yesterday. So there was a lot there were headwinds, if you will in the market. Is that what's going on?

Sam Stovall 02:40
Oh, yeah, a lot of headwinds. And I think a lot of investors are still sort of deciding, is this just a very long fake out of the bear market that is yet to recover all that at last. And I think we're in a new bull market, we did advanced 20% off of the October 12 2022, low. We did that on June 8 of this year. And a lot of technicals, as well as historical data, hinted that 2023 was going to be a very strong year. And it has been at least through July 31, then the seasonal kicked in. And you know, the old saying of Sell in May Well, it really applies more to the third quarter in general and August and September in particular. And then when it comes to October, which is 35% more volatile than the average for the other 11 months of the year, people start to say, Okay, well, then there's there must be different this time, something must be going wrong. I just find it very interesting that people are always willing to say it's different this time when they're dealing with a down market, but it's never different this time when they're dealing with an up market. You're

Pat Bolland 03:49
You're absolutely right. human psychology Sam. Okay, but let's talk tactical just for a second, because the trend line, the trend line has been up for a long time for the S&P 500. And it looks like it's breaking down. I read your most recent report, and you were talking about Fibonacci's now it's been a long time since I talked Fibonacci's. But it seems that the market is really on a precipice right now and could decline sharply.

Sam Stovall 04:14
Well, I think that's the worry that investors have right now. When you look at the overall trend lines that are connecting the the bottoms in March, or an August of this year. Also looking at the 200 day moving average. Yes, I'd learned how to spell Fibonacci just a little while ago. And if 38% correction brings us to around the 4200 level, so that's an important level, listening to other technicians who are talking about a head and shoulders pattern that has been broken. That measured move to the flip side would imply a drop to about 4100. So yeah, I think a lot of people are very nervous as to how far down it's likely to go by But I can't help but think of the presidential cycle as well, which offers a bit of euphoria

Pat Bolland 05:08
Euphoria. Yeah. And people don't know, this broadcast is mostly for Canadians, not exclusively, people in Canada aren't aware of markets are so sensitive to what happens in the presidential races. What kind of market rallies do you seem to get during presidential election years?

Sam Stovall 05:24
Well, the fourth quarter of the pre election year, so meaning this quarter, going back to World War Two, the market on a total return basis, gained nearly 6% and never declined in the first term of a president's administration. So essentially saying that the market more likely than not expects the president to be reelected, and typically follows some fairly weak numbers in the third quarter in general August and September in particular, especially after having a more than 10% advance through mid year, as we saw this year. So obviously, it's not a guarantee, but it is sort of a comforting statistic.

Pat Bolland 06:08
Okay. But there is almost a guarantee out there. When short term interest rates are higher than long term interest rates, what they call the inverted yield curve, it typically means bad news for the stock market, doesn't it?

06:20
Yes, and you can add to that, whenever we've had the year on year CPI exceeds six and a half percent, we have typically fallen into a bear market with a recession, whenever leading economic indicators were negative year on year, we ended up with a bear market and recession. Also looking at a earnings recession, meaning more than two quarters of year on year declines and s&p 500 earnings, we've already had at least three and this quarter right now is expected to be down 1%. But if it follows history, meaning that 54 of the last 56 quarters, we had actual numbers exceed end of quarter estimates, implying that management does a very good job of managing expectations, then this is probably the first quarter in which we're emerging from that earnings recession. But you're absolutely correct. That that also is a an early warning signal for recession, and inverted yield curves. Basically, even if your brother in law is a banker, he's not going to lend you money at a loss. And usually that's what happens when the short rate or the amount by which bankers pay people to deposit money happens to be higher than where they would lend the money. So usually, the bankers pull back on their lending practices, which slows the economy, we do think we're likely to see 1% sub 1% growth in the final quarter of this year, first quarter of next year. But our economists are still holding out for a soft landing.

Pat Bolland 07:52
Yeah. But what I'm hearing, though, is a recession and it flies in the face of jobs, because it looks as though jobs seem to be increasing. Is that typical?

Sam Stovall 08:05
Jobs increasing ahead of a recession? No, that's not typical.

Pat Bolland 08:09
Right.

Sam Stovall 08:10
And I think that no, because of COVID, because of the government's response to COVID, the peoples have been fever that they want to dispel. That's really turned a lot of market adages seasonality, cycles, etc, on their on their head, turn them upside down. And maybe this is one of those times because of the post pandemic response that could maybe delay when we end up having the recession? I mean, we're eventually going to have a recession. It's it really just depends on how far since the beginning of the inverted yield yield curve.

Pat Bolland 08:50
Okay, then the question is, if we do have a recession, and all the signals point to that happening, eventually can the stock market still go up? And that's based on you know, hope for future earnings or a

multiple recovery? In other words, the price compared to the earnings improving what do you what do you think valuations in other words?

Sam Stovall 09:10
Well, first of all, valuation is traditionally expand in the beginning of a new bull market. Going back to World War Two, the PE multiple expansion averaged about 22% between the bear market bottom and the 20% advance which signaled that it was a new bull market, usually because prices lead fundamentals, the price movement tends to advance in anticipation of the earnings. Growing 2024 expectations are for all sectors to post positive results more than half of them in double digit territory with the s&p 500 up about 12% on an earnings basis. If that is if incorrect if the economists are incorrect if the trend lines, performances Is are incorrect than yes, you could say we'll probably fall into a recession with a bear market. But I'm usually pretty slow to say, you know, sell everything and run for the hills because 80% of the time, since World War Two, the s&p has posted a positive, total return. And in those calendar years, also, Americans are optimistic by nature. If you're already bear and wrong, you're ridiculed if you're a bear, and you're right, you're hated.

Pat Bolland 10:30
True. And I've seen that many times myself. Okay. Suppose you know, you were saying that the market could go down to 4200 or 4100 on the measurement. Suppose that the economy is recovering? How quickly does the stock market recover? And what kind of percentage moves are we looking?

Sam Stovall 10:49
Well, we are now almost 7%, down from the July 31, high ... actually, through the end of September, the average decline following the 20%, advance off of a prior bear market low was about 10%. So it's like the messenger from Marathon who, instead of saying, rejoice, we conquer ... says we're new now in a new bull market. Yes, they sort of stumble out of exhaustion, but they don't die. Bull markets tend to continue to advance an average of 18% 12 months after we have recovered by 20%, called ourselves a new bull market, and then digested some of those gains, we are then higher by 18%, after hitting that 20% threshold. So you know, except for the bull market of 1947, through 48. Every other bull market continued to advance. And I think this one will as well.

Pat Bolland 11:51
So despite all that bad news that we have out there currently or possibly in the future, and I know you're not a financial adviser, but you would see this as a potential buying opportunity just to take advantage of what could come.

Sam Stovall 12:05
Exactly. I'm not being a total Pollyanna. Just be left lemons, I do make whiskey sours. But I do acknowledge the fact that yeah, there is a pretty high wall of worry. But the market usually climbs that wall of worry, maybe this ends up being like 1984, like 1992, where people felt we were in a recession. But really, it was more of an economic slowdown from which we recovered. So I think that there's still more volatility ahead of us. But I do think that we will end up with a favorable move in the final two months of this year.

Pat Bolland 12:44
Are there any telltale sectors if you will, I don't know... Airlines, railways, oil and gas and any sector that seems to lead the way. So we could get a, an indicator.

Sam Stovall 12:56
Well, leading the way, on the downside, the old adage is when the going gets tough, the tough go eating, smoking and drinking and if they overdo it, they have to go to the doctor. So typically consumer staples, healthcare do well ... also for utilities, because you have to continue to heat light your home etc. Well, those groups are not doing well at all, that investors are still focusing more on the cyclical plays energy,industrials, communication services, and to a lesser extent, in the near term, consumer discretionary and technology, but you know, but look at a continuing relative strength for those sectors, either on a month to month basis, or on a trailing 10 month basis, which is equivalent to a 40 week or 200 day moving average. And you still find that investors are gravitating toward communication services, technology and to a lesser extent, consumer discretionary.

Pat Bolland 13:54
Yeah, but it's really difficult, at least in my mind, to buy a sector. Diversification I guess, is the key of the s&p 500 because you do get 500 stocks, is that the going line?

Sam Stovall 14:07
Yes. And if you are looking for an area into which to diversify that has been beaten up, and is actually trading at a very steep discount, I would look to the S&P Midcap 400, Small Cap 600 and tothe developed international shares, mid and small cap stocks here in the states are trading at a 30 plus percent discount to their relative PE average going back over the last 20 years. Ditto for the developed international you might have to wait a while but these stocks are trading at about a 20% discount to their relative PE versus the s&p 500 and the international stocks do tend to offer a higher dividend yield so you can get paid while you wait.

Pat Bolland 14:52
Are the international stocks offset for currency risk?

Sam Stovall 14:57
Well, you are adding some currency risk and certainly I As the Fed continues to raise interest rates, the dollar remains fairly firm and starts to creep a little bit higher. Also with the the 10 year yield looking so attractive that attracts money from overseas, they have to buy US dollars before they can buy the stocks or the bonds. And yes, that tends to support that. But to your case, if we do end up in an economic slowdown, then certainly the Fed will stop raising rates, the Fed may have to start to cut rates, and that should cause the 10 year yield to reverse course.

Pat Bolland 15:34
Okay, only time will tell Sam.

Sam Stovall 15:36
Only time will tell

Pat Bolland 15:38
Sam Stovall, CFRA research, Sam thanks yet again to chat. Maybe we'll check in with you in a year's time and see how it all played out.

Sam Stovall 15:45
Yep, look forward to it. Good to talk to you again, Pat.

Pat Bolland 15:47
Thanks, again Sam ...