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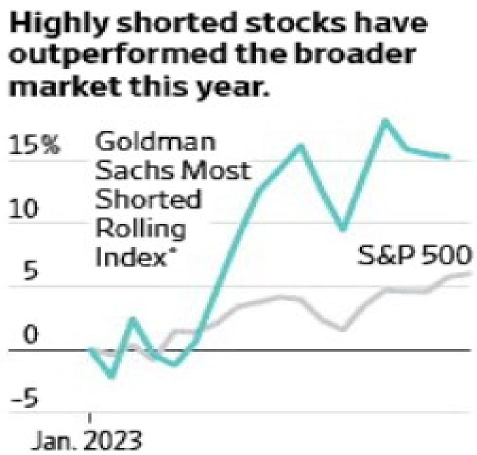
Outlook for 2023

The Dangers of Market Timing

At the end of 2022, almost every strategist and economist on Wall Street was predicting a recession in 2023, making it one of the most anticipated recessions of all time. In addition, a survey by the Conference Board showed that 98% of American CEOs also expected a recession in the coming year.

To show how widespread the bearish opinion was, David Faber, who is one of the most thoughtful of the CNBC commentators and one with his eyes and the ears on hedge fund managers, said that all the supposed "smart money" was looking for a lower stock market in the immediate months to come. **BUT WHAT HAPPENED? January 2023 was one of the strongest months in market history.**

Meanwhile, Wall Street has continued to attribute every market move to the Fed. The below chart proves that is not always so wise.



Note: Index tracks 50 stocks, with a market capitalization greater than $1 billion, which have the highest short interest in the Russell 3000.

Source: Refinitiv in Wall Street Journal, January 30, 2023

Irrational and Extreme Behavior

What adds to the challenge of market timing are the periodic irrational stock moves, like short covering, that have no bearing on fundamentals. Below we discuss some of these extremes.

Most examples of irrational and extreme behavior are when investors become overly excited about the prospects of a company and assume that the price will go higher because the prospects are so phenomenal. We see this somewhat now with the FANG stocks. We saw it following the Tech Bubble, and also with the Nifty Fifty in the 1970s. The example we use here was in an earlier period when RCA dominated the world market for radios, where the prospects were unlimited. The stock went to $60/share and the analysts on Wall Street thought it was too high, but then it went to $80/share, again the analysts were saying too high, then to $100/share, same, and as it turned out, it was too high and corrected despite the company's strong sales and earnings.

Radio Corporation of America Stock Price
(January 1925 – December 1935)

Source: The Wall Street Journal

Because short selling factored in the recent market rise, we want to point out how this area can be impacted by extreme behavior. An example we use was from the 1960s. **A famous hedge fund manager, who was considered by almost everyone to be one of the smartest guys on Wall Street, made the fundamental case for shorting a Bahamas casino company.** He pointed out that the company was extremely over-leveraged, it's accounting was very suspect, and, in his opinion, eventually the stock would be worthless. He started shorting the stock at 15, and as it kept going higher, he kept covering his shorts as the stock continued to move up (in shorting a stock, if the price moves up, you have to keep putting more money to account for the stock's higher price). The stock went to 40, then to 60, and kept going ever higher.

He became exasperated with daily price action of the stock, and decided to go to Australia for a month so he could ignore his short position and escape the pain it was inflicting on him. But before he left, he left instructions with his subordinates to continue to cover his short positions with new cash if the market took the stock still higher. Which it did, going through 100, and then to 120. At that point, he was wiped out. **Shortly after he returned to the United States, the stock crashed and went to zero.**

Another example of surprising behavior can be seen in the chart below. Here we see how in the 2000-2003 NASDAQ correction of 78%, there were four monster rallies during that downtrend of +35%, +25%, +41% and +45%. Talk about a trader's nightmare, and so much for the efficient market.

NASDAQ Performance Post 1999

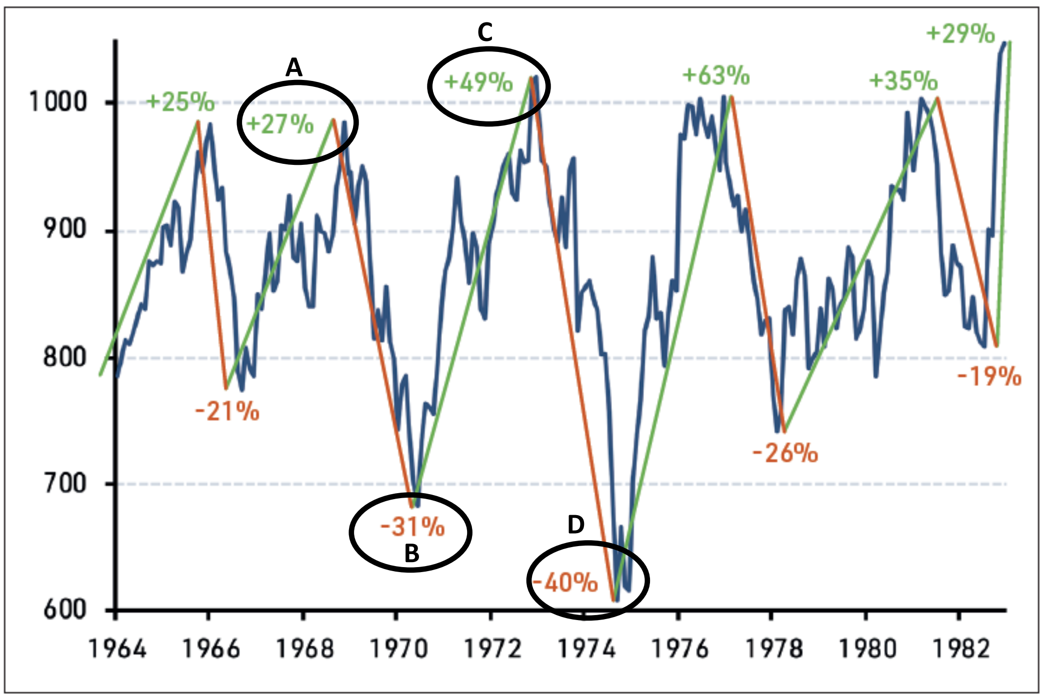
Source: SCCM Research, May 31, 2022

Recessions and Bear Markets

Periods of bear markets and recessions have always added to the difficulty of trying to time the market. The period between 1968 and 1982, shown in the chart below, shows why. It appears as if the market during the entire 14-year period occupied a trading range between 700-1000, basically flat. A closer look shows a market more traumatic than it would appear from the trading range. First, there was the massive speculative run-up in stocks of the late 1960s **(A).** The public got into the market, and brokerage firms were opening offices all over the country. The most popular stocks were small speculative companies and the most active stocks trading were the conglomerates, vulture-like companies built on debt. **But the market finally rolled over and corrected in the recession of 1970 (B),** and most of the speculators and the conglomerates were wiped out.

Then in the early 1970s, the market rallied back up to the 1000 level (C), led by the major institutional banks that had not been lured into the speculative frenzy of the 1960s. The new enthusiasm for stocks centered on the high-quality companies, "The Nifty Fifty" that embodied a new era of technology; among them IBM, Xerox and Eastman Kodak. **When the recession of 1973-1974 arrived (D), many of the old established Wall Street firms got wiped out, and by the end of 1975, the booming Wall Street of the 1960s was a ghost town.**

Dow Jones Industrial Average (1964-1982) – Anything But Flat!



Source: SCCM Research, 2021

The Big Surprise

The shock was that during the 14-year period, if one had bought the bottom 20% of stocks on a P/E basis in 1965 (which none of us at the time were doing) and held them until to 1984, the return would have been a staggering +1,000%. So, the message is clear:

it is okay to be invested, but make sure you invest with a price discipline and make sure you invest for the long-term and not be tempted to change course by the swings of the market.

Why It Works

In our June 2022 mid-year market letter, we pointed why stock market returns over time have been so powerful. It's because the bounce that portfolios receive after a time of a bear market and recession. We reproduce this study below. Other studies have also showed that if one missed the best 13 months of a market cycle following a recession or bear market, and the bounce that comes with recovery, one makes no money being in equities at all. Most of those 13 months lie in the period of the bounce.

S&P 500 Post Bear Market Bounce

Bear Market End	Next 12 Months	Next 24 Months
6/13/1949	42.07%	**59.04%**
10/22/1957	31.02%	**43.66%**
6/26/1962	32.66%	**55.70%**
10/7/1966	33.06%	**41.67%**
5/26/1970	43.73%	**59.71%**
10/3/1974	37.96%	**67.26%**
8/12/1982	59.40%	**61.51%**
12/4/1987	22.40%	**56.94%**
9/21/2001	-12.50%	**7.30%**
7/23/2002	17.94%	**36.17%**
3/9/2009	68.57%	**95.12%**

Source: SCCM Research, 2022

Alternatives

With all the extreme volatility we now see and with a major decline in both the stock and bond market in 2022, money has been looking for alternative avenues of investment. **The case we make is that for long term investors, putting money in value stocks is a great alternative.** See below for the 10-year performance for the bottom 20% of stocks in the S&P 500 by P/E.

Critics of the strategy assert that equities tend to be more volatile than other investments like bonds. **This is true if volatility is measured on a one-year basis. But if one is investing for the long-term, money put into value stocks should establish a new measure of volatility and a better one for the investor.**

S&P 500 Bottom 20% by P/E – Annualized 10-Year Returns

	Bottom 20% by P/E
2013 - 2022	**+11.30%**
2012 - 2021	**+13.45%**
2011 - 2020	**+10.70%**
2010 - 2019	**+13.25%**
2009 - 2018	**+15.42%**
2008 - 2017	**+11.45%**
2007 - 2016	**+9.55%**
2006 - 2015	**+9.58%**
2005 - 2014	**+11.06%**
2004 - 2013	**+12.05%**
2003 - 2012	**+11.73%**
2002 - 2011	**+9.07%**
2001 - 2010	**+10.57%**
2000 - 2009	**+10.92%**
1999 - 2008	**+7.03%**
1998 - 2007	**+12.45%**
1997 - 2006	**+16.13%**
1996 - 2005	**+16.20%**
1995 - 2004	**+18.55%**
1994 - 2003	**+16.46%**
1993 - 2002	**+14.49%**
1992 - 2001	**+17.36%**
1991 - 2000	**+20.23%**
1990 - 1999	**+15.72%**

Source: SCCM Research, 2023 ***Past performance does not guarantee future results.***
Investors cannot invest directly in an index.

Conclusion

Our message has not changed: be invested, be disciplined about price, be a long-term investor, and don't be distracted by all the volatility in the market.

All charts are provided for illustrative purposes only, there is no assurance any market trends will continue.

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