The Cobblestone Advisor
Investment Brief
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COBBLESTONE
CAPITAL ADVISORS

Market Timing 101

Following the S&P 500's first-quarter decline of -4.6%, stocks remained under pressure during the second quarter. The index officially entered a bear market in June and ended the three-month period down -16.1%.

With equities down -20.0% in the first six months of the year, you've likely seen the headlines by now: *Stocks Post Worst First Half Since 1970*. Bonds did not fare much better. By mid-June, broad US fixed income markets had experienced their largest drawdown on record (-14.3%) before ending the second quarter down -4.7% and the first six months of the year down -10.3%.

In all, the second quarter was the worst quarter on record for traditional asset class investors (as measured by a US 60/40 stock/bond portfolio), while the first six months of the year was the worst first half on record.

Main drivers of market performance during the second quarter were similar to those of the first three months of the year: namely, elevated inflation, changing policy interest rates, and what the interplay between the two means for the US economic outlook.

More specifically, monetary policymakers continue to grapple with elevated inflation and appear committed to bringing it closer to their 2.0% target (down from the current level of 8.6%). To achieve this, the Fed has already raised its benchmark interest rate by 150 basis points this year to a range of 1.50%–1.75%. The market has priced in another 175 basis points worth of hikes by year-end, which would take the range to 3.25%–3.50%. By doing so, policymakers are seeking to moderately slow US economic growth by tightening financial conditions just enough to bring down inflation without tipping the US economy into a recession.

Investors, however, are not necessarily convinced that the Fed will be able to successfully walk this tightrope. Rate hike cycles typically coincide with a strengthening economy, whereas the current backdrop has policymakers tightening into a slowdown. This makes it notably more difficult for them to achieve their desired outcome.

In our April Investment Brief, we highlighted the potential for markets to come under pressure if signs were to emerge that suggested deteriorating economic conditions. That is precisely what is happening. Broadly, US economic data have been coming in well below expectations in recent weeks, and leading indicators such as Purchasing Managers' Index (PMI) survey data suggest a continued slowdown in economic activity in the months ahead.

Economists have reacted by sharply reducing their expectations for 2022 US economic growth, from 4.3% to 2.5% as of quarter-end. Similarly, expectations for 2023 have also been revised lower, from 2.5% to 1.9%. The bulk of revisions occurred concurrent with the precipitous decline in US equities, suggesting that markets are pricing in slower growth and rising risk of a recession.

Taking all of this into account, markets appear to be at a proverbial fork in the road, and historical analogs may help to chart the potential paths forward. As seen in the table at the top of the following page, data from the fifteen bear markets since 1950 show that during bear markets that did not have a corresponding recession, the S&P 500 experienced an average decline of -22.3%, whereas the decline was more pronounced

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Total Return (%), Ending 6/30/2022				Annualized		
	Qtr	YTD	1 Year	3 Years	5 Years	10 Years
S&P 500 Stock Index	-16.1	-20.0	-10.6	10.6	11.3	12.9
Russell 2000 (Small-Cap Stocks)	-17.2	-23.4	-25.2	4.2	5.1	9.3
MSCI EAFE (International Stocks)	-14.5	-19.6	-17.8	1.1	2.2	5.4
MSCI EM (Emerging Markets)	-11.5	-17.6	-25.3	0.6	2.2	3.1
Bloomberg Barclays US Aggregate Bond Index	-4.7	-10.3	-10.3	-0.9	0.9	1.5
Dow Jones US Select REIT	-18.1	-21.1	-6.4	2.5	4.3	6.6
Consumer Price Index (% Chg over Period; One-Month Lag)	3.0	4.8	8.6	4.5	3.6	2.4

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S&P 500 Bear Markets Since 1950

Peak	Trough	% Decline	# of Days Peak-to-Trough	Breakeven	# of Days Trough-to-Breakeven
Jul-57	Oct-57	-20.7%	99	Sep-58	329
Dec-61	Jun-62	-28.0%	196	Sep-63	434
Feb-66	Oct-66	-22.2%	240	May-67	209
Nov-68	May-70	-36.1%	543	Mar-72	650
Jan-73	Oct-74	-48.2%	630	Jul-80	2114
Sep-76	Mar-78	-19.4%	531	Aug-79	527
Nov-80	Aug-82	-27.1%	622	Nov-82	83
Aug-87	Dec-87	-33.5%	101	Jul-89	600
Jul-90	Oct-90	-19.9%	87	Feb-91	125
Jul-98	Aug-98	-19.3%	45	Nov-98	84
Mar-00	Oct-02	-49.1%	929	May-07	1694
Oct-07	Mar-09	-56.8%	517	Mar-13	1480
Apr-11	Oct-11	-19.4%	157	Feb-12	144
Sep-18	Dec-18	-19.8%	95	Apr-19	120
Feb-20	Mar-20	-33.9%	33	Aug-20	148
Average (All Periods)		-30.2%	322		583
Average (Recession)		-35.5%	406		784
Average (Non-Recession)		-22.3%	195		281
Current Drawdown*		***-23.6%***	***164***		***N/A***

(i.e., -35.5%) when bear markets had a corresponding recession. The S&P 500's max drawdown in 2022 of -23.6% is consistent with historical non-recession bear markets. Based on what has transpired historically, further market declines are plausible if the US economic outlook deteriorates further. Conversely, if the US economy avoids entering a recession, it's possible that markets could be at/near a bottom.

Regardless of where markets go from here, we would urge investors to resist the temptation of trying to time the market. Market timing is notoriously difficult, and history indicates that the associated opportunity cost can be significant. This opportunity cost is shown in the below table, which highlights six major post-war business cycle downturns. In each one, equity markets declined prior to the downturn in economic growth. Equity markets ultimately troughed while the economy continued to deteriorate.

On average, equity markets troughed nearly four months (116 days) before GDP troughed and had returned 32% by the time economic growth was reported to be accelerating again. This supports the notion that attempting to time the market may lead to missed opportunities for investors who remain on the sidelines until they feel more upbeat on the economy.

In times like these it is important to remember that markets and economies move in cycles. Staying the course through periods of volatility is how you capture long-term returns that are necessary to meet your investment objectives.

The Opportunity Cost of Waiting for Economic Recovery Before Investing

Equity Market Trough	GDP Trough	Days in Between	Equity Market Return by the Time…	
			GDP Troughed	GDP Started Rising Again
Mar-20	Jun-20	91	20%	30%
Feb-09	Jun-09	122	25%	44%
Oct-90	Mar-91	151	23%	22%
Jul-82	Sep-82	61	12%	31%
Sep-74	Mar-75	182	31%	50%
Dec-57	Mar-58	90	5%	13%
Average		116	19%	32%

Source: (First Table) awealthofcommonsense.com, Cobblestone, Bloomberg. Includes periods when intraday decline was >20% but closing price decline was <20%. *Current drawdown assumes trough on June 16, 2022. (Second Table) JP Morgan, Bloomberg. Uses month-end dates for equity market and GDP troughs.

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