

US Strategy Snapshot

Bear Fables and Bull Facts

Bottom Line: After a strong January, US stocks have experienced choppy trading in February with the S&P 500 index dropping below the 4,000 level for the first time in a month, rejuvenating the bears. In fact, over the past few weeks, we have been inundated with subjective bearish statistics and commentary that are not necessarily supported by the hard objective facts, according to our work. As such, in this report, we lay out some of these facts as it relates to bear markets and US recession timing, Fed tightening cycles and performance implications, and leadership trends following market lows.

Main Points:

- **Bear Markets & US Recessions**
 - ✓ Nine of the previous 13 S&P 500 bear markets have coincided with US recessions
- **Fed Tightening Cycle Conclusions and Performance Implications**
 - ✓ S&P 500 average price returns tend to be positive, but fairly muted in the months leading up to the end of Fed tightening and pretty strong in the months after the cycle concludes
- **Prior Leadership Is Rarely the New Leadership**
 - ✓ Bear markets often bring a change in leadership to US stocks with the sector leaders preceding the bear period rarely the same ones coming out of it

Investment Strategy

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US Strategy – S&P 500 Targets

Price Target Model	2023E
DDM	4,500
Fair Value P/E	4,000
Price Target	4,300

EPS Target Model	2023E
Macro Regression	\$210
Bottom-Up Consensus	\$230
Normalized EPS	\$197
EPS Target	\$220
Implied P/E	19.5x

Source: BMO Capital Markets Investment Strategy

US Strategy – Recommended S&P 500 Sector Weightings

Sector	Opinion	Tgt. Wgt.
Communication Services	OW	9%
Consumer Discretionary	MW	10.5%
Consumer Staples	UW	4.5%
Energy	MW	5.5%
Financials	OW	13%
Health Care	OW	16.5%
Industrials	MW	8%
Information Technology	MW	26%
Materials	MW	2.5%
Real Estate	MW	2.5%
Utilities	UW	2%

Source: BMO Capital Markets Investment Strategy

OW: Overweight

MW: Market Weight

UW: Underweight

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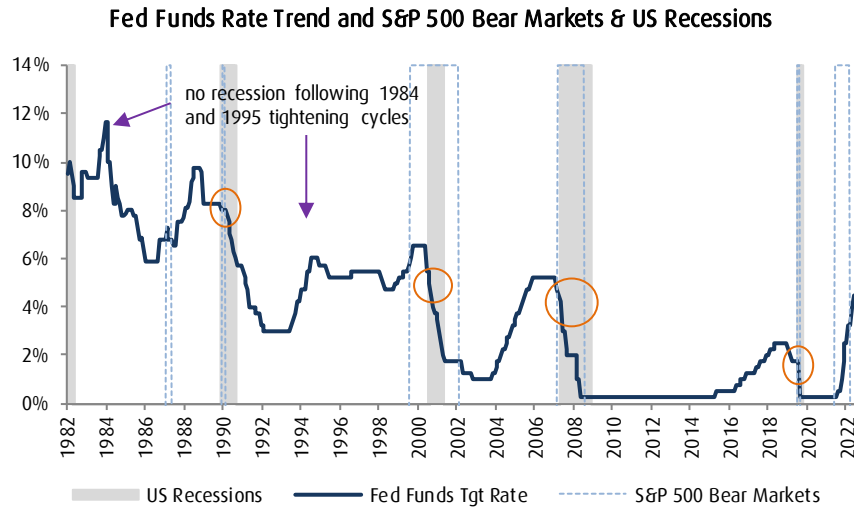
Bear Markets & US Recessions

S&P 500 Bear Markets Typically Coincided With US Recessions, But Not Always

S&P 500 Bear Markets			
Peak Date	Trough Date	Coincided With or Preceded Recession?	S&P 500 Price %Decline
5/29/1946	10/9/1946	No	-26.6%
6/15/1948	6/13/1949	Yes	-20.6%
8/2/1956	10/22/1957	Yes	-21.6%
12/12/1961	6/26/1962	No	-28.0%
2/9/1966	10/7/1966	No	-22.2%
11/29/1968	5/26/1970	Yes	-36.1%
1/11/1973	10/3/1974	Yes	-48.2%
11/28/1980	8/12/1982	Yes	-27.1%
8/25/1987	12/4/1987	No	-33.5%
7/16/1990	10/11/1990	Yes	-19.9%
3/24/2000	10/9/2002	Yes	-49.1%
10/9/2007	3/9/2009	Yes	-56.8%
2/19/2020	3/23/2020	Yes	-33.9%
1/3/2022	10/12/2022	???	-25.2%

Source: BMO Investment Strategy Group, FactSet, FRB, NBER.

Bear Markets & Recessions Tend to Occur Well After End of Fed Tightening Cycles

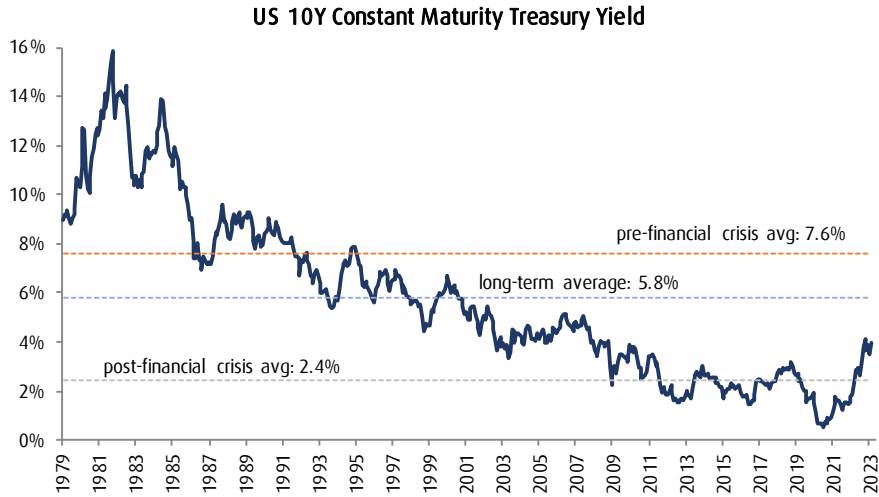


Source: BMO Investment Strategy Group, FactSet, FRB, NBER.

- The market and investors alike have become obsessed with “the recession call”, based on our client interactions.
- The US economy may very well fall into a recession by the end of year, and in fact, our 2023 base case scenario price and EPS targets for the S&P 500 calls for a mild recession. That being said, it is important to note that we will likely not know whether a recession has indeed occurred until several months after the fact given the lag time for the National Bureau of Economic Research to officially determine the business cycle peak and trough.
- Looking back historically, our work shows that S&P 500 bear markets typically coincide with US recessions. Of the previous 13 bear markets we identified since 1945, only four did not coincide with or immediately precede a US recession – 1946, 1961-62, 1966, and 1987. Therefore, there is a possibility that the recession that many investors have been calling for has already occurred or does not even occur at all (soft landing).
- When examining the timing of bear markets and recessions in relation to Fed tightening cycles, our work shows that bear markets and recessions tend to take place well after the conclusion of Fed tightening cycles, as seen during the 2020, 2007-09, 2000-02, and 1990 periods. However, it is also possible for the US economy to avoid a recession altogether following the end of interest rate hikes as was the case in the aftermath of the 1995 and 1984 tightening cycles.

Fed Tightening Cycle Conclusions and Performance Implications

Current US 10Y Treasury Yield Is Roughly Half the Pre-Financial Crisis Average Yield



Source: BMO Investment Strategy Group, FactSet, FRB.

S&P 500 Average Price Returns Tend to Be Fairly Muted in Months Leading Up to End of Fed Tightening, but Pretty Strong in Months After the Cycle Concludes

S&P 500 Price Performance Leading Up to and Following End of Fed Tightening Cycles

End of Tightening Cycle	Months Prior to End of Tightening Cycle				Months Following End of Tightening Cycle			
	-12M	-9M	-6M	-3M	+3M	+6M	+9M	+12M
8/9/1984	3.4%	1.0%	6.5%	3.4%	1.2%	10.1%	9.9%	13.8%
2/24/1989	8.6%	13.3%	10.0%	6.7%	11.1%	22.4%	19.8%	12.9%
2/1/1995	-1.9%	4.3%	2.0%	0.4%	9.3%	19.0%	24.2%	35.7%
5/16/2000	9.6%	10.2%	3.2%	5.6%	0.9%	-6.4%	-11.2%	-12.3%
6/29/2006	6.1%	3.7%	1.5%	-2.3%	4.9%	11.4%	11.8%	18.1%
12/20/2018	-7.9%	-9.2%	-10.8%	-15.8%	14.5%	19.7%	21.3%	30.6%
Average	3.0%	3.9%	2.1%	-0.3%	7.0%	12.7%	12.6%	16.4%
Avg of Last Four Cycles	1.5%	2.2%	-1.0%	-3.0%	7.4%	10.9%	11.5%	18.0%
Avg Ex 2018	5.1%	6.5%	4.6%	2.8%	5.5%	11.3%	10.9%	13.6%

Source: BMO Investment Strategy Group, FactSet, FRB.

End of Tightening Cycle Does Not Mean Market Peak Is Imminent

End of Fed Tightening Cycles and S&P 500 Price Peaks

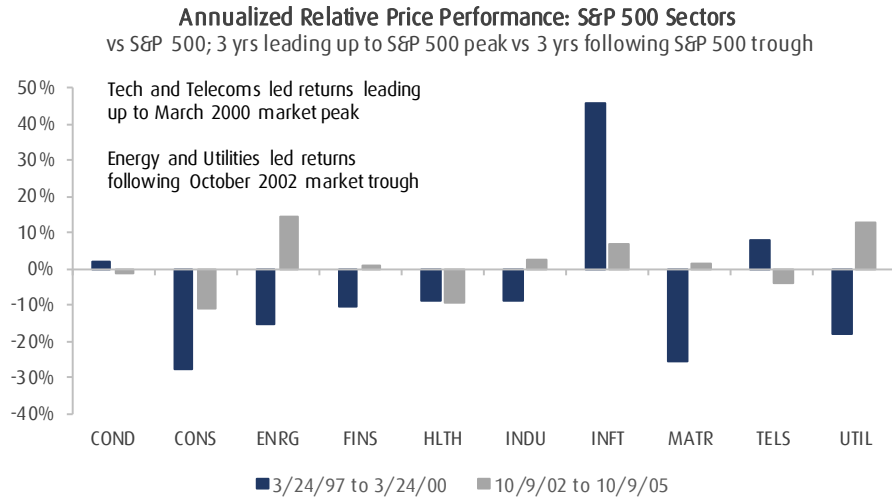
End of Tightening Cycle	S&P 500 Price Peak	Days From End of Tightening to S&P 500 Peak
8/9/1984	no immediate peak	
2/24/1989	7/16/1990	507
2/1/1995	no immediate peak	
5/16/2000	3/24/2000	-53
6/29/2006	10/9/2007	467
12/20/2018	2/19/2020	426

Source: BMO Investment Strategy Group, FactSet, FRB.

- The US 10-year Constant Maturity Treasury yield has increased more than 40bps this month to 3.95%, slightly higher than the yield at the start of the year. Rising yields always tend to worry investors so it is important to put this level into perspective. Going back to 1979, the long-term average yield is 5.8%, while the pre-financial crisis average is 7.6%, nearly double the current US 10-year Constant Maturity yield.
- On the tightening front, while the specific timing of the final rate hike by the Fed may be up for debate, it is safe to say that the current tightening cycle is nearing an end, which has historically been a positive for US equity performance.
 - ✓ The months preceding the conclusion of the previous six tightening cycles have been met with fairly muted stock market returns with the S&P 500 logging just a 2.1% average gain during the six months prior. That being said, the index saw gains during five of the six cycles with stocks exhibiting losses only in the six-month period leading up to the December 2018 cycle.
 - ✓ The months following the end of Fed tightening cycles have typically seen pretty strong gains. On average, the S&P 500 posted gains of 7%, 12.7%, and 16.4% in the three-, six-, and 12-month periods following the conclusion of tightening cycles.
- In addition, our work shows that end of tightening cycles does not mean a market price peak is imminent. Indeed, when the Fed stopped raising rates in 2018, 2006, and 1989, the S&P 500 did not peak until well after a year, while the end of the 1995 and 1984 cycles were not met with any immediate price peaks at all. Only the 2000 period exhibited a market peak prior to the Fed concluding its rate hiking cycle.

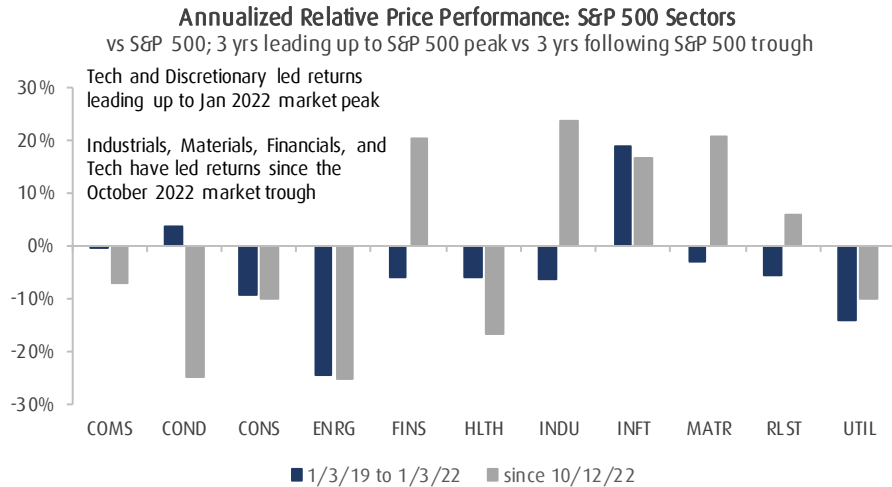
Prior Leadership Is Rarely the New Leadership

ENRG & UTIL Took Over Market Leadership From Tech & Telecom Following Oct 02 Trough



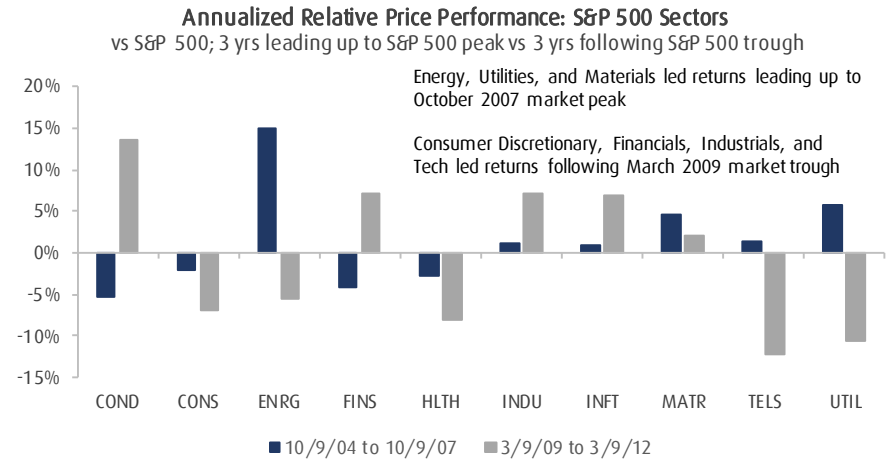
Source: BMO Investment Strategy Group, FactSet.

Technology & Discretionary Stocks Topped Gains During the Three Years Leading Up to Jan 2022 Peak, While INDU, MATR, FINS, and TECH Have Led Performance Since Oct 22 Low



Source: BMO Investment Strategy Group, FactSet.

COND, FINS, INDU, & TECH Assumed Leadership From ENRG, UTIL, & MATR After Mar 09 Low



Source: BMO Investment Strategy Group, FactSet.

- Bear markets often bring a change in leadership to US stocks. Indeed, our work shows that sector leadership preceding a bear market is rarely the same leadership coming out of one.
- For instance, we examined annualized sector relative performance during the three-year period leading up to the 3/24/00 S&P 500 price peak and compared this to performance during the three years following the 10/9/02 trough. Technology and Telecoms were the standout performers going into the March 2000 peak, but Energy and Utilities took over market leadership after the October 2002 trough. Similarly, in the three years preceding the 10/9/07 S&P 500 price peak, Energy, Utilities, and Materials led sector returns, but once the market troughed on 3/9/09, Discretionary, Financials, Industrials, and Technology assumed leadership within US equities.
- In the most recent cycle, Tech and Discretionary topped returns during the three-year period leading up to the 1/3/22 peak. If this trend of changing leadership out of bear markets continues, these aforementioned sectors are unlikely to be the standout performers during this current cycle. In fact, we may already be seeing some early signs of this as Industrials, Materials, and Financials have been the sector leaders since the 10/12/22 low, despite Tech also outpacing the market as well. To be clear, although Tech and Discretionary stocks may not be the sector leaders during this cycle based on changing leadership trends, that also does not necessarily mean the groups will underperform either.

Recent US Strategy Research Reports

Date	Title
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2/15/2023	US Strategy Snapshot: Improving Market Breadth Underpins Recent Equity Rally
2/2/2023	US Strategy Comment: Earnings Pessimism May Be Overstated
1/20/2023	US Strategy Comment: Our Take on the New Price Low Debate
1/12/2023	US Strategy Comment: Reinforcing Our Market Call and 2023 Price Target
12/13/2022	US Strategy Comment: 2023 US Sector Positioning
12/8/2022	US Strategy Comment: Thematic Report – Reshoring 2.0
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10/24/2022	US Strategy Snapshot: Style, Size, and Multiple Trends Heading Into Year-End
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9/21/2022	US Strategy Factor Focus: Navigating the Market Cycle With Factor Models
9/13/2022	US Strategy Comment: Tackle Volatility With Quality and Dividend Growth
8/18/2022	US Strategy Comment: Steer Toward GARP in Discretionary and Technology
8/11/2022	US Strategy Snapshot: Profit Margin Resilience on Display
7/27/2022	US Strategy Snapshot: Focus on Domestically Oriented Stocks Within Industrials
Monthly Reports	
2/8/2023	US Strategy: US Chartbook – February 2023
2/8/2023	US Strategy: US Factor Profiles – February 2023
2/8/2023	US Strategy: US Multi-Factor Profiles – February 2023
Investment Strategy Snapshots and Special Reports	
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9/6/2022	Investment Strategy Comment: Hold the Line

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Buy	Outperform	49.0 %	18.0 %	54.4 %	53.7 %	57.3 %	57.7%
Hold	Market Perform	48.6 %	13.9 %	41.8 %	44.6 %	40.3 %	37.5%
Sell	Underperform	2.5 %	25.0 %	3.8 %	1.5 %	1.9 %	4.8%

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http://researchglobal.bmocapitalmarkets.com/documents/2013/rating_key_2013_to_2016.pdf

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