



Market Commentary  
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English Version

# Tough to Get a Bear Market Absent a Recession

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**insigneo**



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## Tough to Get a Bear Market Absent a Recession

A growth scare or slowdown is not a recession. It is too early to de-risk further given poor market performance.

The Fed will eventually induce a US recession once inflation resumes its upward trajectory after a temporary dip later this year.

Stay invested with neutral allocations to pro-risk assets, tilted defensively in equities and heightened levels of commodities, real-estate and other assets that perform well in an environment of rising rates.

We are now neutral on long duration assets like US Treasuries and Growth factors after being

underweight since the middle of last year with most of the rise in rates front-loaded.

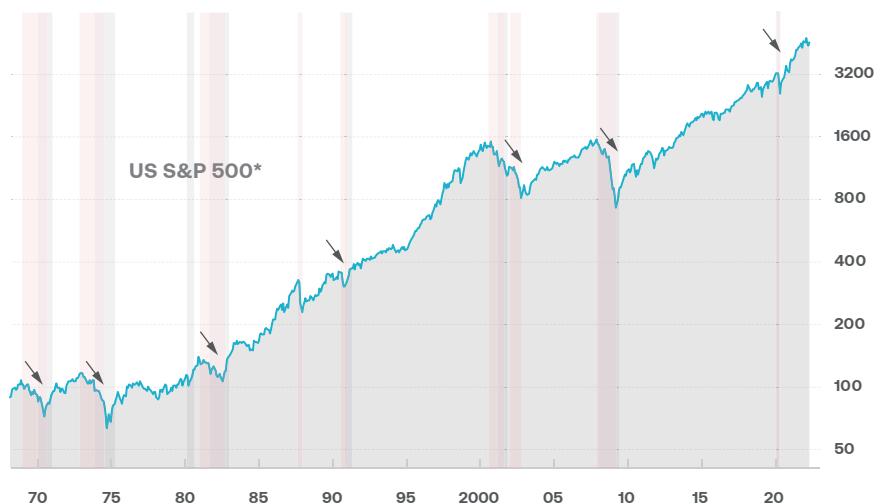
Absent a recession, we will once again underweight these assets as yields have further to rise over the long-haul.

April was a trying month for investors as there was virtually nowhere to hide from tumultuous markets. Financial assets were roiled by three simultaneous risks: resurgent Chinese Covid-related lockdowns, the ongoing Russian invasion of Ukraine, and hawkish surprises to the path of monetary policy in the developed world, particularly in the US. The MSCI All Country World Index tumbled -8.14% and is now down -13.41% for the year. US equity markets fared no better as their benchmark index, the S&P 500, registered its worse month since the initial pandemic-induced shutdowns of March 2020, falling -8.80% and dragging the YTD decline to -13.31%. In fact, in calendar terms, the index suffered its worst April performance since 1970 and its most negative start to the year since 1957. Most recently, the market plunged below the 4200 level that served as soft support for the approximate trading range of 4600 to 4200 established since the Russian invasion of Ukraine back in February. On the last trading day of the month, the index fell below 4170, the March 8th closing low. Consequently, investor sentiment turned extremely negative (e.g., the American Association of Individual Investors' bearish inclination reached levels last seen during March 2009 when the market bottomed after the Global Financial Crisis), and the market suffered some technical damage. While the latter does not portend well for the market in the near-term, the former is almost always a contrarian buy signal over the next 12 months. Moreover, historical market performance around the initial Fed rate hike also bodes well for gains in the second half of the year after the market gets passed the initial phase of heightened volatility. Going back fifty years to 1972, after the initial increase in rates, the median yearly gain for the S&P 500 was 6% with only one

### Recessions and Bear Markets Tend to Overlap

Bear Markets  
 NBER-Designated Recessions

\* Log Scale



Source: BCA Research / Bloomberg

instance in December 1976 when the market was negative 12 months afterward (-7%).

For now, we still believe that pro-risk assets still have some upside over the second half of the year as the probability of a US, or even global, recession is not elevated enough to warrant a more bearish tilt in asset allocation, especially given the poor performance thus far. Our proprietary recessionary indicator, which posits the chance of a US recession within the next 6 months is only in the mid-teens. The threshold for us to de-risk is a reading at 40% or above. For the market to reestablish its footing, however, a few critical risks need to be clarified beforehand. First, there must be some further corroborating evidence that near-term inflation has peaked to mitigate the Fed’s increasingly hawkish tone. To that end, we will be closely watching the May 11th release of US CPI data for signs that the worst of the pandemic-related surges are behind us. In fact, the US inflation outlook improved marginally with downticks in the March PCE and the Dallas Fed’s Trimmed Mean PCE prints, two of the central bank’s favored inflation gauges. To be sure, we do not need to see a precipitous drop in inflation as prices should remain

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well above average for the remainder of the year. Rather, we need to see signs that it is no longer accelerating. That would allow monetary policy tightening expectations to soften or stop rising. US private and corporate balance sheets are still in excellent financial shape as surpluses accrued during the pandemic should be enough to shield consumer spending and business capex from rising rates for the remainder of the year. Indeed, household and business spending seem poised to increase over the coming quarters, as opposed to retrenching during

a recession. The current earnings seasons attests to this strength. As of this writing, with just over half of US companies reporting, over 75% of companies have beat earnings estimates and almost 70% have beat on revenue. The Chinese macroeconomic landscape has possibly also reached an inflection point as Covid cases are now falling and the government will provide ample support to reach its economic growth target. The Fed Put may be gone, but the Chinese Put is still there. In our view, the biggest risk to the overall market remains the Russian invasion of Ukraine as there is less clarity now on its resolution. But our two core theses around it have not changed since the war began – the conflict will not spillover out of Ukrainian territory and involve NATO combatants and Russian oil and gas flows to Europe will not come to a sudden halt. If one or both of these pillars should fail, then our recessionary forecasts will materially change.

There is an old adage in the market that a correction is always “healthy, normal, and necessary...until you’re in one.” Just as markets are grappling with numerous

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worries at the moment, we similarly see a plethora of reasons to believe that a bear market has not begun and that investors should remain invested through neutral allocations to equities and other pro-risk assets. As long as an economic contraction is not in the offing, corrections tend to end only when many investors think the bear market has already begun.

# House Views Matrix

|                                      | TACTICAL<br>(UP TO 3 MONTHS) | CYCLICAL<br>(UP TO 12 MONTHS) |
|--------------------------------------|------------------------------|-------------------------------|
| <b>US Equities<sup>1</sup></b>       | NEUTRAL                      | OVERWEIGHT                    |
| <b>European Equities</b>             | NEUTRAL                      | NEUTRAL                       |
| <b>Japanese Equities</b>             | NEUTRAL                      | OVERWEIGHT                    |
| <b>Emerging Market Equities</b>      | NEUTRAL                      | OVERWEIGHT                    |
| <b>Chinese Equities</b>              | OVERWEIGHT                   | NEUTRAL                       |
| <b>US Treasuries<sup>2</sup></b>     | NEUTRAL                      | UNDERWEIGHT                   |
| <b>Investment Grade Fixed Income</b> | NEUTRAL                      | UNDERWEIGHT                   |
| <b>High Yield Fixed Income</b>       | NEUTRAL                      | NEUTRAL                       |
| <b>Emerging Market Sovereign</b>     | NEUTRAL                      | NEUTRAL                       |
| <b>US Dollar</b>                     | NEUTRAL                      | UNDERWEIGHT                   |
| <b>Energy<sup>3</sup></b>            | NEUTRAL                      | OVERWEIGHT                    |
| <b>Precious Metals</b>               | NEUTRAL                      | OVERWEIGHT                    |
| <b>Cash</b>                          | OVERWEIGHT                   | NEUTRAL                       |

<sup>1</sup> Relative to global equities in USD

<sup>2</sup> Relative to aggregate fixed income markets in USD

<sup>3</sup> Relative to an overall commodity allocation



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