Harry's Take

January 24, 2023

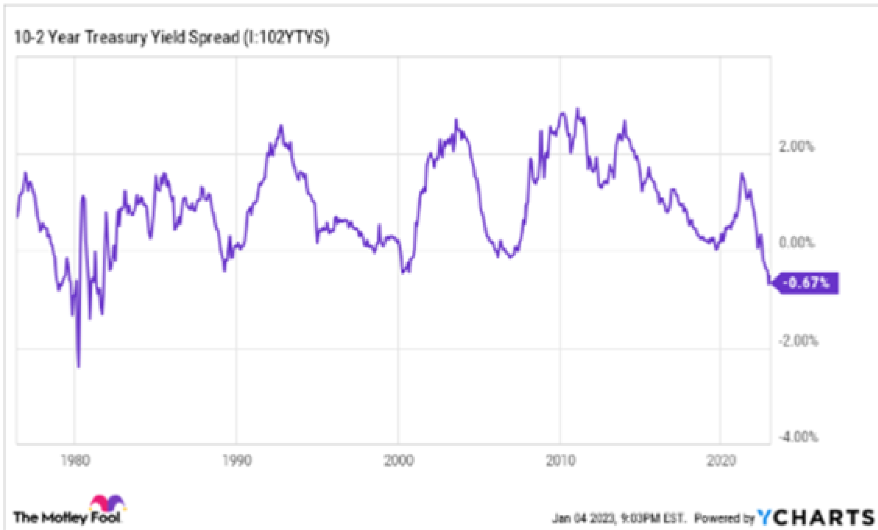
The First Crash That Started Before the Fed Started Easing

The normal cycle is that the economy starts to slow into a recession, the stock market anticipates that ahead of the fact, the Fed steps in and starts lowering interest rates to ease, and then the stock market eventually rallies when investors see the next upturn ahead.

This time, the stock market started heading down first, after the Nasdaq peaked on November 22, 2021, and the broader S&P 500 peaked on January 4, 2022. The Fed started tightening by raising the fed funds rate in March 2022 and is only now looking at moderating the rate hikes—not at pausing or lowering rates again yet. If the economy keeps weakening and heading toward a recession as most economists now expect, such a pause or pivot back to stimulus is likely at least a few months away, at this time.

Economists keep hoping for a pivot soon, but Jerome Powell has been clear that the Fed is serious about fighting the highest inflation in over 40 years. He would look ridiculous if he suddenly pivoted back to stimulus after tightening. That would really make the economy look weak.

Yield Curve Most Inverted Since 1980: Deep Downturn, Not Shallow



Source: https://www.fool.com/investing/2023/01/08/12-stock-market-predictions-for-2023/

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Over the past 50 years, inversion of the yield curve, with short-term rates higher than long-term rates for U.S. Treasuries, has been one of the most reliable predictors of recession. This chart shows that this is indeed the worst inversion since early 1980, and the recession into early 1983 that followed was the worst since the Great Depression (up to that time), more similar to what happened from late 2007 to mid-2009. I have been warning from the beginning that this downturn and stock crash would be about 1.5 times the magnitude of the one from late 2007 to 2009. This chart seconds that warning.

Here is a quote from a recent article by Sean Williams on Motley Fool: "The longest bear market on record lasted 929 days, the current bear market may top it." Why? The larger inversion. The downturn that was most similar to this one happened after the first tech bubble into May of 2000. That downturn took 645 days to bottom, which suggests that this one could come around September 2024, near the "summer of 2024" stock-market-bottom prediction I have been making.

The market has moved more sideways than down since its first crash into June 2022. That 34% crash, which morphed into 38% for the Nasdaq, finally qualified for a top on the Nasdaq on November 22, 2021. The S&P 500 finally peaked on January 4, 2022. It takes a first crash of over 30% to break a major bubble like this.

But if that was the major top (which could come with a downside of as much as 86% on the S&P 500 and 92% on the Nasdaq by mid- to late 2024), then stocks should head down again, soon after moving more sideways since June. The next move should take us down well over 50%, and then investor sentiment will change, as it becomes more obvious that we are in the crash of our lifetime.

Harry

Got a question or comment? You can contact us at info@hsdent.com.