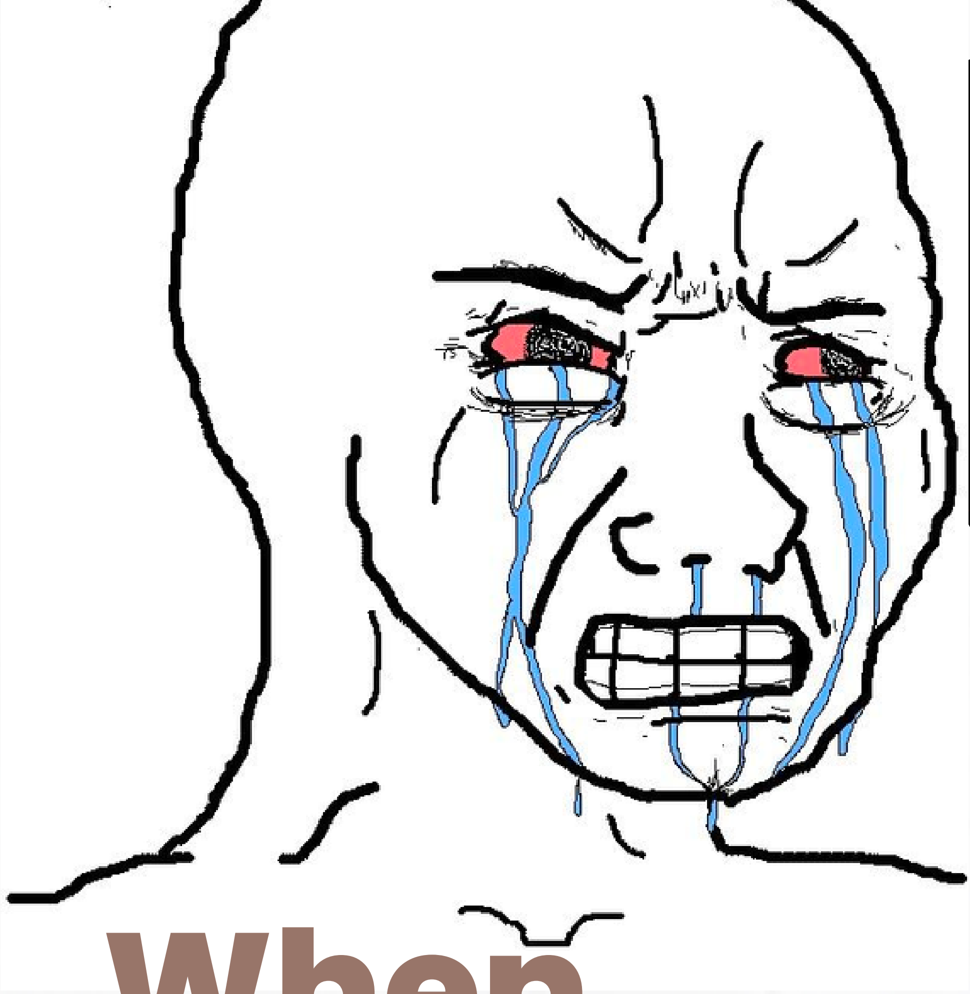
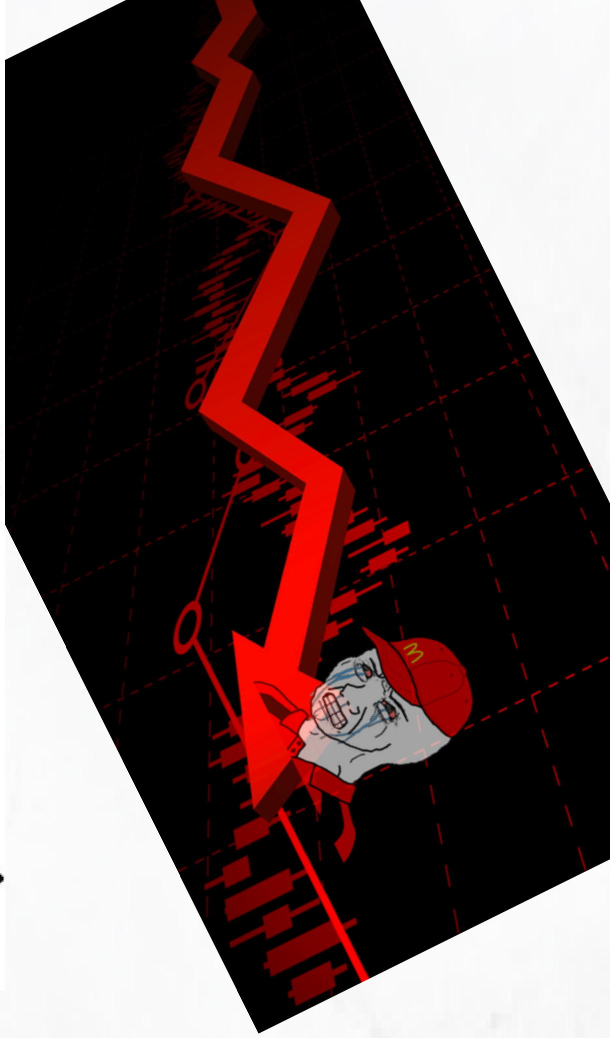




When will the market bottom?

Introduction

Unless you have been living under a rock, you must have heard talk about the impending recession and how bad the economic conditions have been. In this report, I attempt to forecast when the US equity market will hit rock bottom using historical fed fund rate cycles and provide suggestions for what retail investors should do to benefit from this situation.

Background info for the clueless (powered by chatgpt)

The federal funds rate (interest rate) is a number that tells banks how much they have to pay to borrow money from each other. It's like the price of borrowing money.

When the federal funds rate is low, it's cheap for banks to borrow money, so they might be more likely to do it. When the federal funds rate is high, it's expensive for banks to borrow money, so they might be less likely to do it.

The federal funds rate can affect the capital markets in a number of ways. For example, when the federal funds rate is low, it can encourage borrowing and risk-taking, which can lead to increased investment and economic growth. On the other hand, when the federal funds rate is high, it can discourage borrowing and risk-taking, which can lead to decreased investment and economic growth.

Background info (continued)

The adjustment of federal funds rate is also called monetary policy. The US government may want to reduce the federal funds rate to stimulate the economy and encourage growth, or it may want to increase the federal funds rate to slow down the economy and reduce the risk of inflation. The Federal Reserve will use its tools, including adjusting the federal funds rate, to try to achieve its monetary policy objectives.

Fed pivot cycles

The term "Fed pivot" refers to a change in the monetary policy stance of the Federal Reserve. To capitalise on the situation, we need to understand where we are in the cycle. Historically, the fed pivots on the fed fund rates have been highly predictable and it usually follows three main stages.

Stage 1: Slower increase

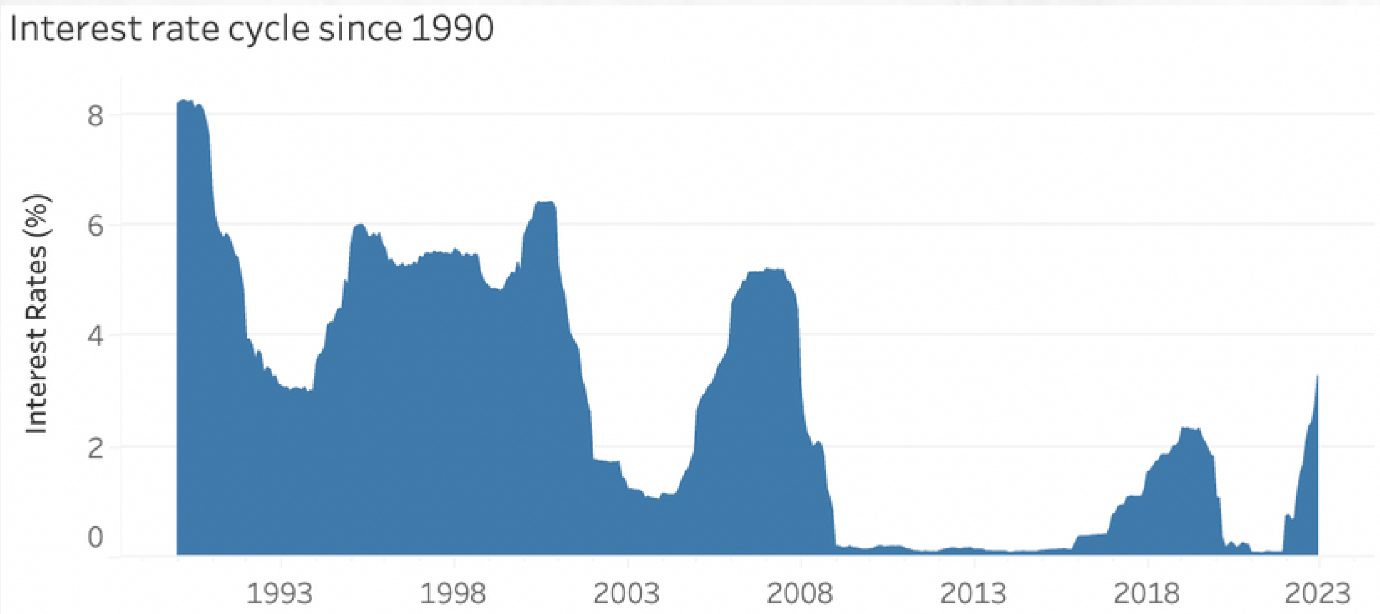
In the first stage of the pivot, the feds will begin to increase rates at a decreasing rate. This is the current stage we're in, as of 14 Dec 22, rates only increased by 0.5% compared to the previous 0.75% hike.

Stage 2: The pause

In the second stage of the pivot, the feds will maintain rates at a fixed level for a prolong period of time in order to drive inflation down to the target level of 2% (current level is 7.1%). Historically this period can range anywhere from 6 months to 1 year.

Stage 3: The drop

In the last stage, the feds begin to decrease rates to stimulate the economy (usually happens near/in recessions).

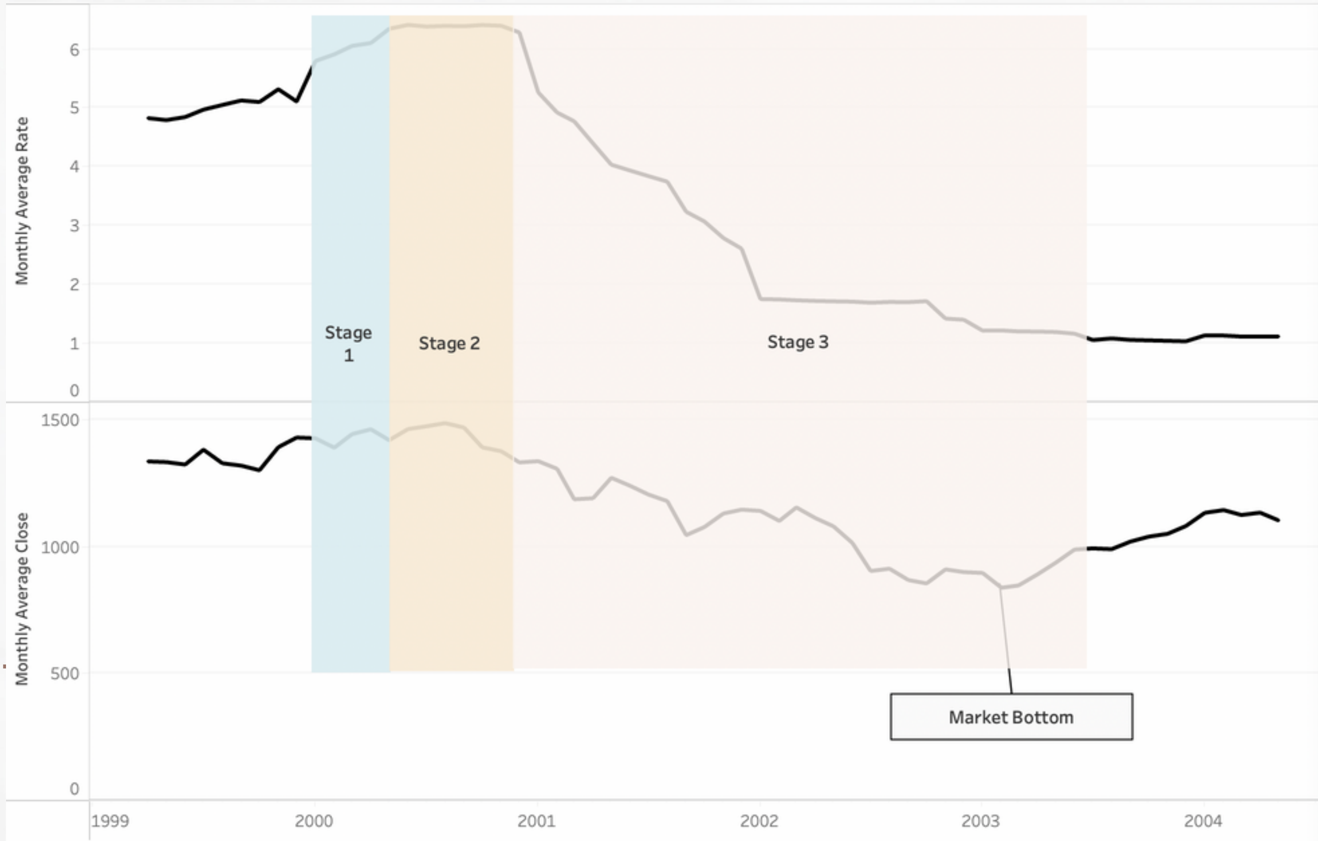


US Equity Markets and its movements with the various cycles

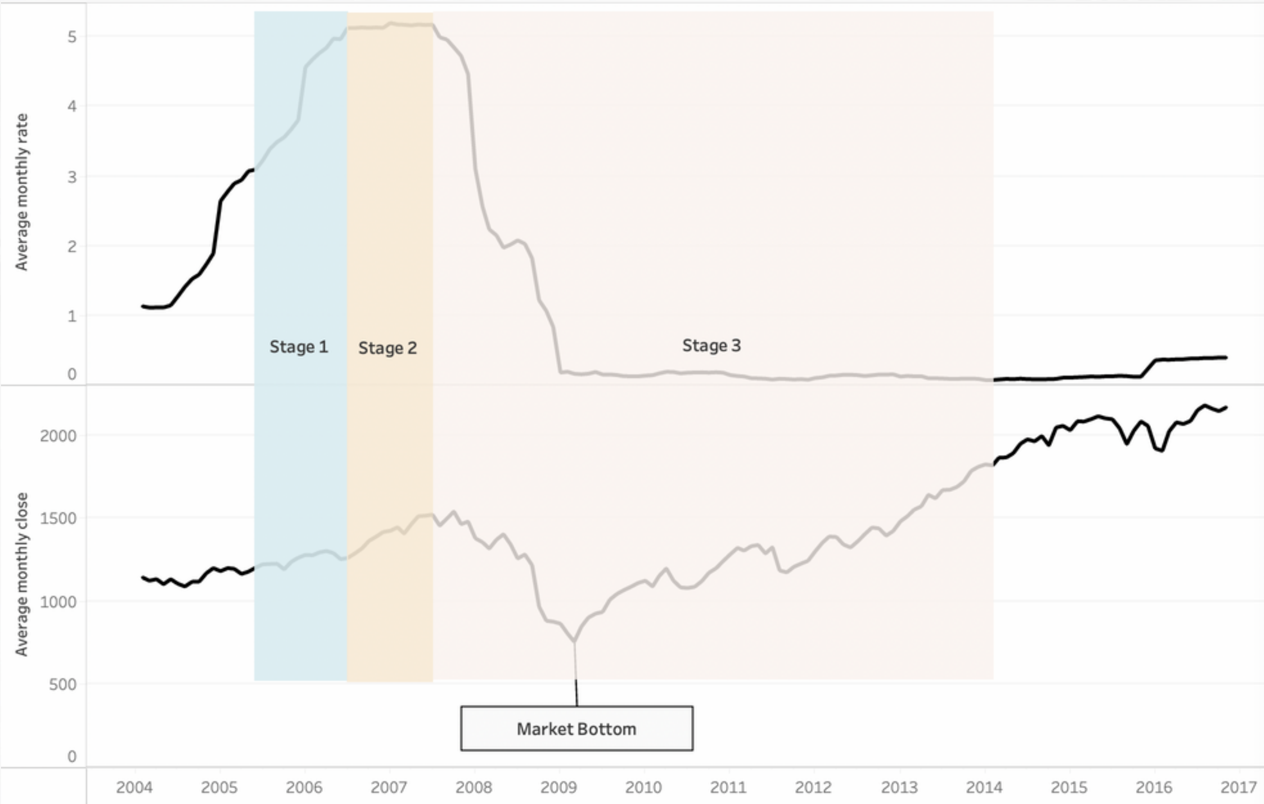
In this report, I will be using the S&P 500 index as a proxy to gauge the performance of the US equity market. The S&P 500 index is a market-capitalisation-weighted index of 500 leading publicly traded companies in the U.S..

For this section, I will be comparing the past three fed pivot cycles with the monthly average S&P 500 closing price.

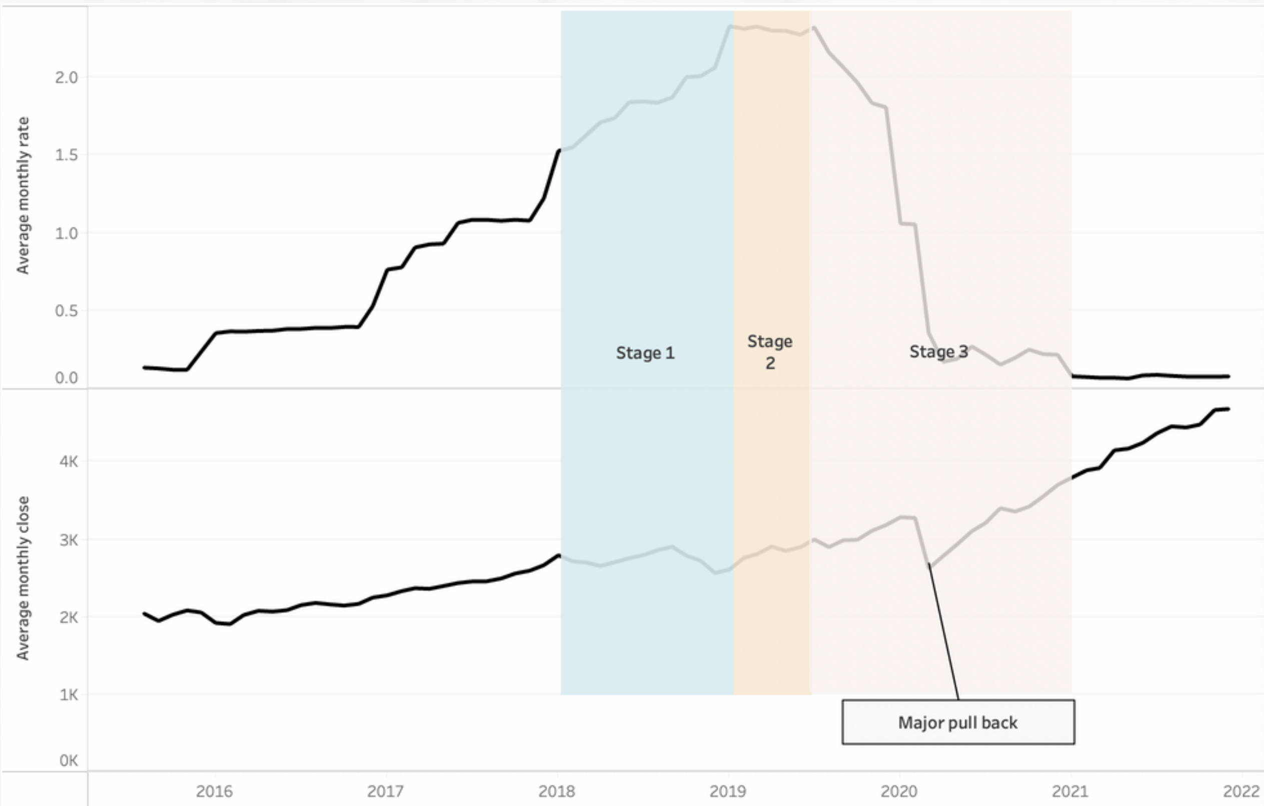
1999 to 2004 cycle



2004 to 2016 cycle



2016 to 2021 cycle



Commentary

In each of the comparisons above, the top graph depicts the fed funds rates, and the bottom graph depicts the average monthly performance of the S&P 500 during the cycle. Although the market performance during each stage of the cycle is highly unpredictable, we were able to identify where the market bottoms in each of the cycles. In each cycle, the market always bottoms or pulls back significantly in stage 3. This is significant in forecasting when the market will bottom in our current cycle.

Forecast

As of December 14th, 2022, we have officially entered stage 1 of the Fed pivot. Some predictive work is needed to forecast the timing of each stage, so here are the pieces of the puzzle. As it stands, the current interest rate sits between 4.25% and 4.5%. The Federal Reserve wants to get the interest rate up to 5% and 5.25%, and 17 out of 19 of the Federal Open Market Committee (FOMC) board members, who make the decision, want the interest rate to be at least 5%. The next couple of FOMC meetings, where interest rates will be adjusted, are on January 31st, 2023, March 21st, 2023, and May 2nd, 2023. Therefore, it is highly likely that we will see the Fed enter stage 2 of the pivot on one of those dates.

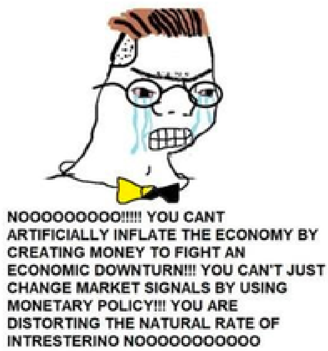
Next, stage 3 - the stage that matters most for us retail investors. Jerome Powell, the Chair of the Federal Reserve, mentioned in the last FOMC meeting that we should expect stage 2 to last throughout 2023, as they are not intending to cut interest rates until 2024. However, I would take what he said with a pinch of salt, as that decision is based on the assumption that the US economy will be able to withstand all the pain in stage 2. Leading up to stage 3 of the pivot, we can expect high interest rates, quantitative tightening, and a nasty recession. This means that bankruptcies, layoffs, and market crashes (in the stock market, cryptocurrency market, and real estate market) will become more common. The Federal Reserve will begin to cut interest rates when something gives, and the debt markets will be the first to do so. There will be a liquidity crisis because they cannot do aggressive quantitative tightening and a rapid increase in interest rates without something breaking - that is wishful thinking. The credit market is bigger and more important than the stock market or the cryptocurrency market, and when the debt market dries up, debt will also dry up, bringing the stock and cryptocurrency markets down with it. With all of these factors in consideration, my prediction is that the Fed will enter stage 3 of the pivot in Q4 of 2023.

$$$ BUY LOW, SELL HIGH $$$

To make money in the equity market, we want to buy stocks at a low price and sell them at a high price. Easier said than done? Actually, it isn't. History has proven to us time and time again that the market bottoms in stage 3 of the fed pivot and the bull run begins a couple of months after stage 3. Therefore, it is not important to capture the exact timing of the bull run; we just need to identify the right period to enter the market and ride the bull run to the top.

So what is my strategy?

1. Stockpile enough cash and liquid assets before stage 3.
2. Research and identify companies with strong fundamentals to buy up in stage 3.
3. Dollar cost average (DCA) heavily into those companies once stage 3 begins to take shape. As long as we are DCA-ing into the market during stage 3, we are sure to capture the bottom of the market
4. Ride ur way to the top... ez moneh



Disclaimer

No part of this report should be considered as financial advice. This report was done purely out of boredom and I bear no responsibility for any poor financial decisions anyone may make (though I would welcome credit if good decisions were made :D). Minimal research was conducted for this report, and everything mentioned may be the result of strong confirmation bias based on my preconceived opinions.

Thots, koncernz, kuestions?

Email: weida@student.unimelb.edu.au