Truist Advisory Services, Inc.

Market Perspective from the Investment Advisory Group

Risk/reward greatly improved as selloff appears overdone

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Key takeaway

The weight of the evidence in our work suggests the market's risk/reward has greatly improved. The market selloff appears overdone near term and is likely within a few percent of finding support.

What happened

As we discussed more recently, investors appear to be concerned about the timing and pace of monetary policy tightening, the persistence of inflation, and potential profit margin pressure. And now we can add building geopolitical tensions surrounding Russia and Ukraine.

Consequently, the S&P 500 is currently down 11% from its early January peak, while other areas of the market, such as small caps and growth, are down even more.

Our take

Pullbacks are never comfortable, because they come with bad news. This time is no different. But pullbacks are the admission price to the market. Moreover, our work shows that following shallow pullback years, such as 2021, the following year tends to have deeper pullbacks, with an average maximum average intra-year pullback of 13%.

So while the 11% current pullback feels abnormal, history suggests it's typical. The surprise in our view, is less that we are seeing a pullback this year, but how quickly it came right out of the gate to kick off 2022.

The good news is our work suggests markets have already gone a long way to pricing in some of these concerns. The bar has been lowered to a point at which a little bit of good news could go a long way. Recall, markets tend to bottom on fear. And we are seeing abundant fear in the market.

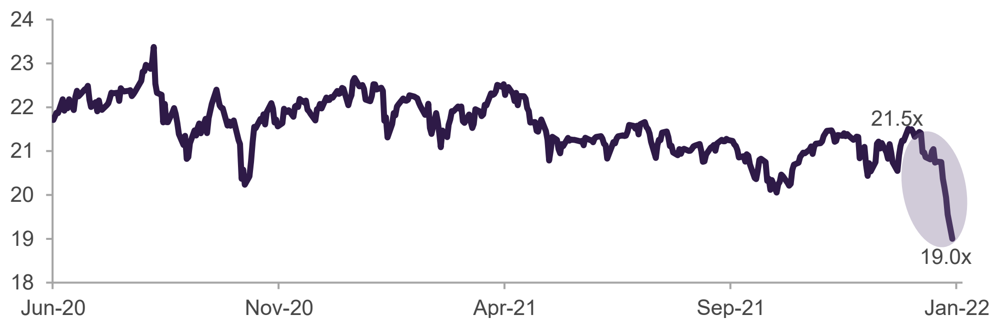
- The percentage of individual investors who consider themselves bullish has fallen sharply to just 21%, the lowest level since July 2020, according to the most recent survey from the American Association of Individual Investors (AAII).
- The Volatility Index (VIX), also known as the fear index, has spiked to the highest level since January of last year and prior to that in October 2020, right before the election. On

each occasion, the market rallied over subsequent months. The demand for downside market protection in the options market, or the put/call ratio, has spiked to the highest level since March 2020, during the depths of the pandemic.

From a fundamental perspective, the S&P 500’s forward price-to-earnings ratio has de-rated from 21.5x to 19.0x currently. This is the lowest level since early during the pandemic.

If we stress test our assumptions, and consider that the S&P 500’s P/E contracts to 18.5x against $225 forward earnings estimates or remains at 19.0x against a lower earnings number of $220 that brings us to fundamental support around 4160-4180, which is less than 2% away from current levels.

S&P 500: Foward P/E

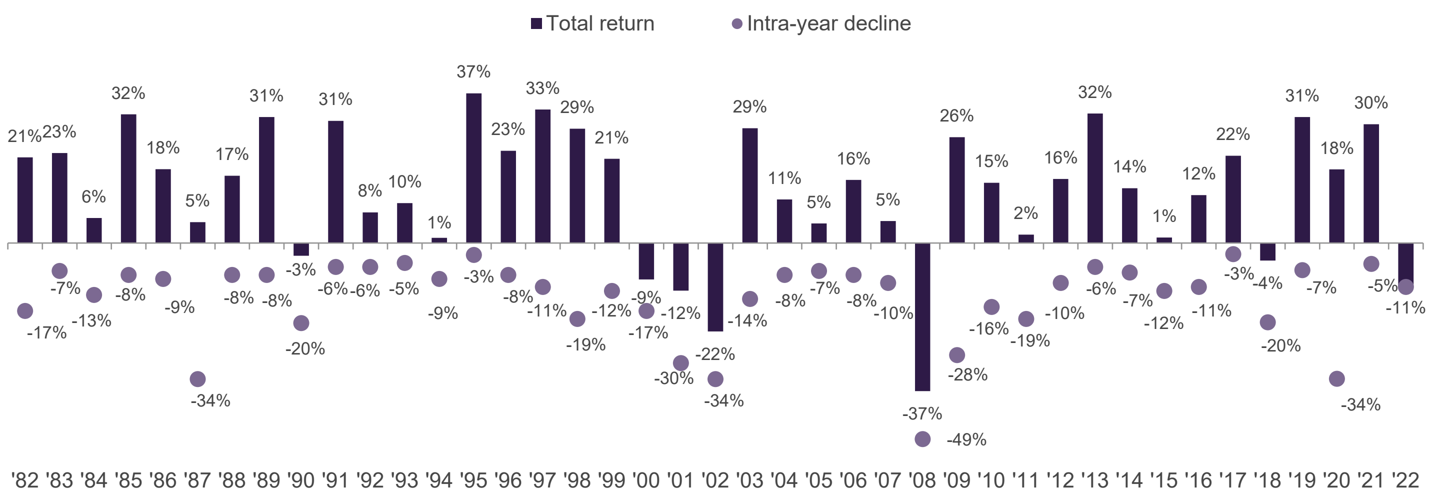


Data source: Truist IAG, FactSet

We view this as a reasonable assumption. The equity risk premium, which measures the earnings yield of stocks relative to bond yields, is now above three percentage points. This is an elevated level and historically has tended to see stocks outperform bonds by double-digits, on average on a one-year forward basis.

Importantly, over the past 40 years, the market has averaged a maximum intra-year pullback of 14%. Despite this, stocks have still shown an average return (not compounded) of 14% and risen in 34 of 40 of those years, or 85%. Moreover, since the 2009 market low, stocks have risen more than 600%, despite 25 corrections of at least 5% by our count.

S&P 500 maximum intra-year declines versus calendar year total returns



Past performance does not guarantee future results. 2022 return and drawdown is year to date as of the intra-day low on 1/24/22. Data Source: Truist IAG, FactSet

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Bottom line

After a year of unusually shallow pullbacks, market turbulence has returned. And the current pullback is magnified given the market has been so sanguine. Nevertheless, as we look at the backdrop and see an economy still on solid footing, earnings which we expect to remain resilient, and attractive relative valuations, we find more reasons for optimism than negativity over the year.

It’s also important to remember that fear and greed can shift quickly. Today’s concerns may become tomorrow’s market catalyst if some of the aforementioned fears prove to be overdone. This is our base case. Accordingly, we continue to advocate an equity bias.

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S&P 500 Index is comprised of 500 widely-held securities considered to be representative of the stock market in general.

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