Truist Advisory Services, Inc.

Market Perspective from the Investment Advisory Group

Who let the bears out?

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Highlights

- The range of potential outcomes is wide, and the risk/reward is less positive than it has been over the prior two years. Therefore, we downgraded equities to a neutral outlook in early April and retain this view.
- One factor that has contributed to keeping us from downgrading equities further is depressed sentiment.
- The most recent survey from the American Association of Individual Investors (AAII) showed a spike in the percentage of bearish investors to the highest level since March 2009.
- Bearish investors now outnumber those that are bullish by one of the largest margins of the past 35 years.
- Likewise, over the past two weeks, there has been a total of $46 billion in equity outflows, another extreme.
- Although many challenges remain, depressed investor expectations and a low hurdle rate for positive surprises are among the biggest assets for the market today.

What happened

With global markets down double-digits this year, and daily headlines that include worsening China lockdowns, the ongoing Russia-Ukraine war, a global economic growth slowdown, multi-decade highs in inflation, and the Federal Reserve on the move, it's little wonder why investors' mood remains dour. As we discussed recently, this mindset is now being reflected in various measures of investor sentiment, which have moved toward an extreme.

Our take

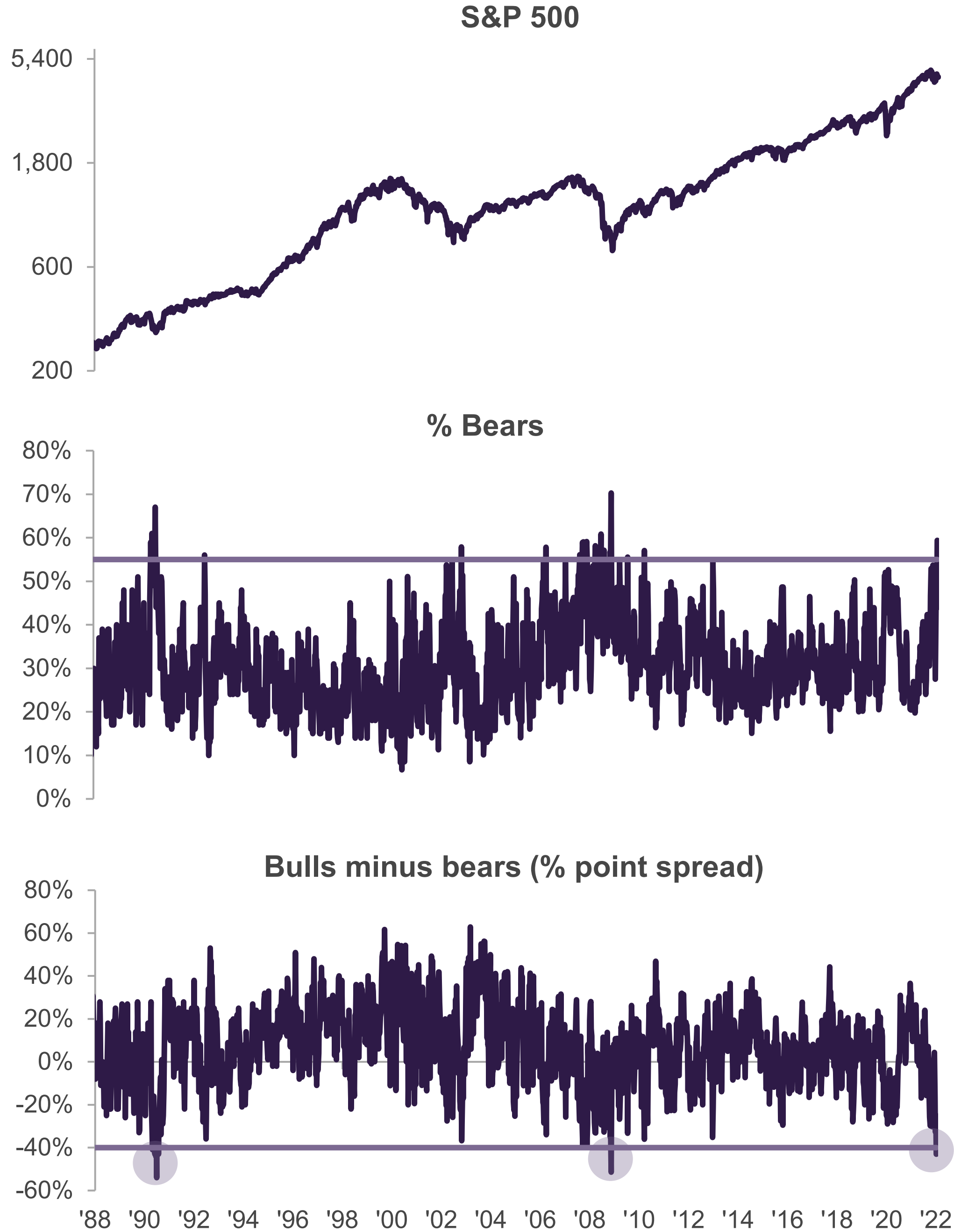
Several of the aforementioned challenges are why we downgraded our view of equities to neutral in early April after having held a positive view of equities for the prior two years. The range of potential outcomes is wide, and the risk/reward is less positive than it had been.

However, one factor that has contributed to keeping us from downgrading equities further is depressed sentiment. Indeed, with markets, it's not about *good or bad* – it's all about *better or worse* relative to expectations. When expectations are low, a little bit of good news can go a long way. That's why markets tend to bottom when fear and uncertainty are at an extreme.

The most recent survey from the American Association of Individual Investors (AAII) showed the percentage of **investors holding a negative/bearish outlook jumped to 59.4%. This is the highest percentage of bears since early March 2009,** which was a few weeks short of the major stock market bottom following the financial crisis decline (charts on next page). To be fair, investors were correctly negative in January 2008 in the early stages of that market downturn.

Still, with the percentage of bullish investors at just 16%, also near a record low**, the spread between the bulls and bears is at -43%. This was previously only surpassed twice over the past 35 years – in the fall of 1990 and in the aforementioned March 2009 period**.

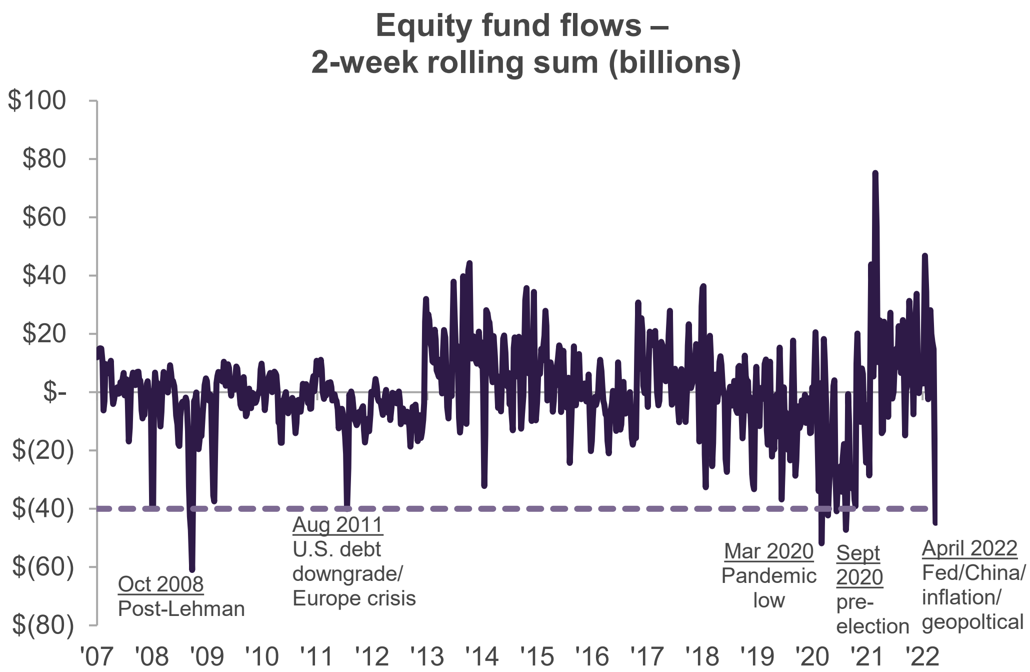
In October 1990, the U.S. was in recession, which coincided with the Federal Reserve (Fed) raising rates and a sharp move higher in oil prices on the back of Iraq invading Kuwait. The extreme bearishness in this survey coincided closely with the low point of that market downturn and was followed by a 30%-plus rise in the S&P 500 over the subsequent year.



Data Source: Truist IAG, FactSet, AAII. Past performance does not guarantee future results.

We are seeing investors take action on their more negative outlook**. Over the past two weeks, we have seen a total of $45 billion in equity fund outflows** (chart on next page). **This is an extreme that we have also seen during times of heightened uncertainty and volatility**.

This included the post-Lehman bankruptcy, the U.S. debt downgrade, the depths of the pandemic, and the two months prior to the 2020 election. The post-Lehman signal was premature, but the other periods were followed by strong price returns over the next year.



Data Source: Truist IAG, FactSet, ICI. Past performance does not guarantee future result

Bottom line

We focus on a weight-of-the-evidence approach. That approach led us in early April to move toward a more neutral view of equities relative to the past few years when the evidence and outlook was heavily skewed to the positive side. We maintain this view today. However, while only one factor in our work, depressed investor expectations and a low hurdle rate for positive surprises are among the biggest assets for the market today.

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