

MARKETS BARRON'S TAKE

Stocks Have Already Bottomed. How We Know.

By Jacob Sonenshine [Follow](#) Nov. 22, 2022 5:18 pm ET

There are mounting signals that the stock market has already marked its low point.
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The ride upward won't be easy, but there are mounting signals that the stock market has already hit its low point.

For starters, the S&P 500 **SPX +0.18%** is down 17% from its all-time high of 4796 hit in early January. It was down as much as 25% to its lowest close of the year of 3577, hit in early October. One key driver was that the Federal Reserve has been ratcheting interest rates higher in order to combat high inflation by reducing economic demand. That's even after the inflation had already begun denting consumer demand. Plus, faster-growing technology companies have seen their valuations, or their stocks' multiples of expected earnings, take a hit partly because higher rates make future profits less valuable. Those companies are expecting a bulk of their profits to come many years in the future.

The thesis that the market has already bottomed hinges on the idea that inflation looks to have already peaked. The Consumer Price Index for October gained 7.7% year over year, down from 9.1% in June. Some of that is because higher prices, themselves, have caused consumers to turn away from shopping; retail companies have too much inventory and have had to mark prices down because demand isn't strong enough for

the supply. Plus, interest rates have already risen, though higher rates have more work to do in reducing inflation to the Fed's 2% target.

That inflation has peaked could mean short-term interest rates have also peaked. The federal-funds futures market is reflecting that the pace of rate hikes will slow down, before the Fed ultimately cuts rates in 2023. The two-year Treasury yield, a barometer for expectations about the fed-funds rate, is around 4.5%, below its multiyear peak of just over 4.7%. The assumption is that inflation and demand will be somewhat curbed by that point, so there's a visible end to the Fed's demand destruction. That would ultimately provide relief for the stock market.

To that point, "if the economy manages to avoid recession or experiences only a modest contraction, a new bull market may already be unfolding," wrote Jim Paulsen, chief investment strategist at The Leuthold Group.

A peak in short-term rates could also mean the 10-year yield, a key component to stock-market forecasts, has also peaked. Higher short-term rates have played a role in pushing the 10-year yield higher this year, but recently, the 10-year yield has dropped to around 3.7% from a multiyear peak of just over 4.2%. That's partially because higher short-term rates should ultimately reduce demand and long-term inflation, lowering the yield on the long-dated bond. That's key for stocks because a lower yield on 10-year government debt increases the value of future profits, boosting equity valuations.

All of these indicators, though, do point to weakening economic demand. Earnings forecasts might have to decline in the next few quarters. Wall Street hasn't cut earnings estimates for 2023 as much as they have historically by the end of a calendar year. And this isn't a normal year; earnings pressure could be worse, given the risk of a recession.

But the stock market would likely resume rising before actual earnings results hit bottom. The stock market historically tends to hit bottom three to six months before earnings estimates bottom, according to RBC data. To be sure, if profit forecast drop enough, stocks would find a new bottom. But if earnings expectations drop even by 11% from here, and the S&P 500 doesn't fall as much, the index would remain above its low for the year.

Plus, an environment with profit projections falling likely includes falling bond yields. If company earnings—and stocks—are declining, then investors could rush into safe 10-year government bonds, the interest payments of which are guaranteed. That would bring the 10-year bond's price up, and yield down. The yield is attractive anyway, as it's well above average annual inflation expectations for the next decade of 2.31%. In this scenario, a falling 10-year yield would support—or even boost—earnings multiples even while earnings projections are dropping.

If it sounds like stock market volatility is in store overall, that's because it is. The S&P 500 could even revisit its low for the year.

There just won't be enough economic destruction—or time—for the market to reach a new low before it sniffs out the end of all the carnage.