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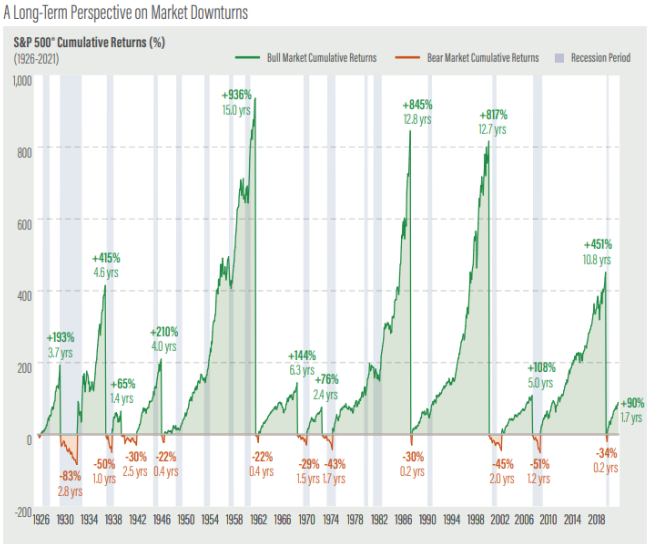
There is an old Wall Street proverb that "nobody rings a bell at market tops and bottoms". At first glance, this adage seems both self-evident and reasonable, as it simply points out the obvious fact that market timing is, at best, both highly challenging and very difficult to do successfully on a consistent basis. Indeed, many wealth management experts and numerous academic studies maintain that it is useless, and even counter-productive, to attempt to time the twists and turns in the markets.

After all, while no guarantee of future results, with bear market losses since the late 1960s averaging less than 20% of bull market gains, and the average bull market lasting five times as long as the average bear market, history has shown that time strongly favors equity investors who are long-term-oriented, and who stick to their strategic investment plan (1).

Greatly complicating any attempt at market timing is the incredibly counterintuitive nature of investing, where market timing success often requires an investor to sell when the markets are euphoric, when investing seems easy and gains are plentiful, and to add to their investments when the markets are dominated by panic-selling and investor despair, both of which require a very strong constitution.

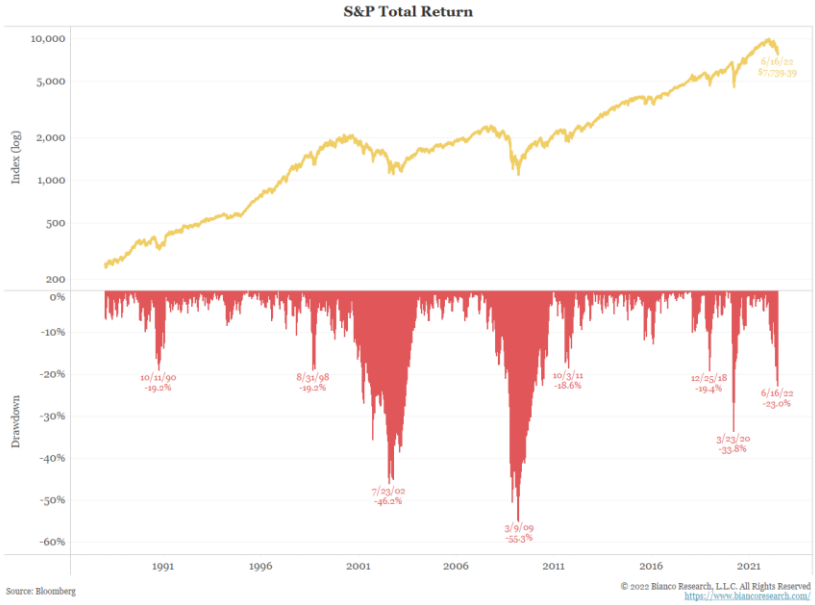


As such, many investors who try to time the markets end up doing the exact wrong thing at the exact wrong time, by ramping up the risk in their portfolios during the euphoria generally associated with market peaks, and panic-selling during the capitulation and abject fear normally associated with a market bottom.

Even worse, many investors who sell near the market lows end up being either too scared or too convinced that the market will just end up falling again if they get back in, and end up missing the rebound.

History suggests that the consequences of such panic-selling become particularly dire once the S&P 500 crosses below the -20% bear market threshold, as it just did on June 16th. According to Barron's, in 75% of all bear markets since 1950, the S&P 500 has been higher by an average of 6.4% just three months after first crossing below the -20% threshold, and a year after first breaking below that threshold, the S&P 500 has been up 75% of the time, and by an average of 17% (2).

Indeed, for some inexplicable reason, numerous significant declines in the S&P 500 have exhibited a tendency to end right around that -20% mark. That includes the declines in 1990, 1998, 2011, and 2018, each of which ultimately declined by between -18.6% and -19.4%.



Moreover, even when the full -20% bear market requisite is achieved, a new bull market has often started in relatively short order.

According to research from Charles Schwab (3), the time from the initial crossing of the -20% level to the start of the next bull market spanned only "39 days in 1966; six days in 1987; 36 days in 1990; the same day in 1998; 12 days in 2011; the same day in 2018; and 11 days in 2020".

The Schwab report continued, the "four exceptions to these brief periods were: the start of the 1970s when it took 117 days; the end of the inflation era in the early 1980s when it took 157 days; the early 2000s Tech Wreck where it took 595 days to bottom; and the 2008-09 Great Financial Crisis, which took 241 days."

Stocks Do Well After They Go Into A Bear Market

S&P 500 Index Performance After Going Into A Bear Market (1950 - Current)

		S&P 500 Index Returns		
Date Bear Market Starts	Trading Days To Enter Bear Market	3 Months	6 Months	12 Months
10/21/1957	305	5.2%	9.3%	31.0%
5/28/1962	115	7.3%	11.2%	26.1%
8/29/1966	139	7.9%	17.6%	24.6%
1/29/1970	288	-4.9%	-8.9%	10.7%
11/27/1973	221	0.7%	-9.2%	-28.1%
2/22/1982	310	3.0%	1.3%	32.1%
10/19/1987	38	10.9%	14.7%	22.9%
3/12/2001	242	6.3%	-7.4%	-1.2%
7/9/2008	188	-20.0%	-27.2%	-29.1%
3/12/2020	16	21.0%	34.6%	59.0%
Average		3.8%	3.6%	14.8%
Median		5.8%	5.3%	23.8%
Higher		8	6	7
Count		10	10	10
% Higher		80.0%	60.0%	70.0%

Source: LPL Research, FactSet 05/20/22
All indexes are unmanaged and cannot be invested into directly. Past performance is no guarantee of future
Performance back to 1950 incorporates the performance of predecessor index, the S&P 90.

Obviously, the past is not necessarily prologue, and there is little doubt that the equity markets are currently confronted with an unusually large number of negative influences and catalysts. That said, it may be wise to remember the advice of Warren Buffet to "be fearful when others are greedy and greedy when others are fearful", and the insight from Sir John Templeton who noted: "Bull markets are born on pessimism, grow on skepticism, mature on optimism and die on euphoria." Today's environment seems to have surpassed pessimism, and has arguably ventured well into the realm of despair.

None of the above is to advocate a purely laissez-faire and/or passive approach to investing, or to suggest that one should not adjust portfolio risk in light of the level of risk in the macroeconomic environment. Indeed, we believe that such an approach, which we view as very different from market timing, can be highly rewarding.

Under such a tactic, an investor would maintain a level of risk near the lower end of their "risk spectrum" when inflation is high, the economy is slowing, corporate profits are under pressure, and interest rates are high and/or rising, as examples, and adopt allocations closer to the upper end of their risk spectrum when the opposite conditions prevail.

Bear Market Details

	Market Events	Market Peak	Bear Declines	Duration (years)	Cumulative Returns of the S&P 500®[1] 1 Year Later	2 Years Later
1	Crash of 1929 - Started the Great Depression	Sep 1929	-83%	2.8	162.89%	146.90%
2	1937 Fed Tightening - Premature policy tightening	Mar 1937	-50%	1.0	35.18%	59.01%
3	Post WWII Crash - Post-war demand tapering	May 1946	-30%	2.5	61.23%	74.04%
4	Flash Crash of 1962 - Flash crash, Cuban Missile Crisis/Cold War jitters	Dec 1961	-22%	0.4	8.01%	12.72%
5	Tech Crash of 1970 - Economic overheating, civil unrest	Nov 1968	-22%	0.4	31.16%	59.37%
6	Stagflation (High Inflation/Slow Growth) - OPEC oil embargo	Jan 1973	-29%	1.5	41.83%	57.07%
7	Federal Reserve (Volcker) Tightening - Whip Inflation Now	Nov 1980	-43%	1.7	38.14%	80.19%
8	1987 Crash - Program trading, overheating markets	Aug 1987	-30%	0.2	23.33%	61.36%
9	Tech Bubble - Extreme valuations, .com boom/bust	Mar 2000	-45%	2.0	24.40%	41.65%
10	Global Financial Crisis - Housing bubble, Lehman collapse	Oct 2007	-51%	1.2	53.62%	88.30%
11	Global COVID-19 Crisis	Feb 2020	-34%	0.2	56.35%	??
	Averages	—	**-40%**	**1.3**	**48.74%[2]**	**68.06%[2]**

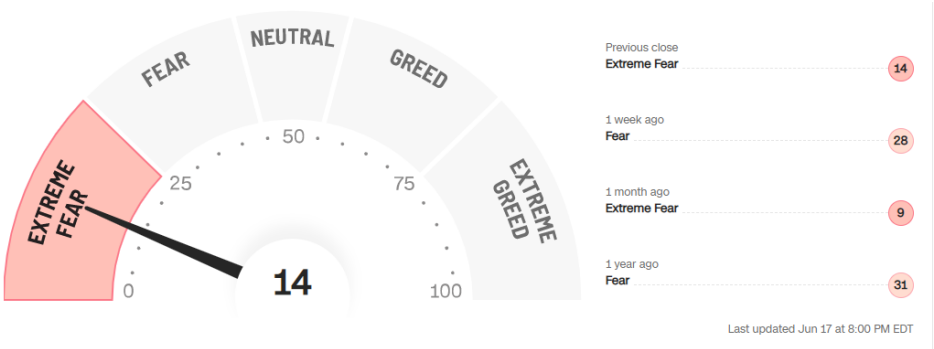
Source: MSNBC, FactSet, and S&P Dow Jones Indices. The index is unmanaged, is not available for investment and does not incur expenses. Monthly returns are shown for S&P 500® Index, except for the COVID-19 Crisis, which is daily.

As of December 31, 2021.
[1] Based on the closest month-end date after the bear market end date. Uses monthly returns.
[2] Average does not include most recent bear market.

Among other things, when done properly, such a strategy can help to limit losses and reduce volatility during market declines, while creating at least a modest allocation to cash that can be put to work once there is evidence that a sustainable bottom is in place.

One would be correct to note that this last statement certainly insinuates certain elements of market timing, which we acknowledge is challenging and potentially counter-productive in the midst of a sustained uptrend or downtrend, largely because there are so many different factors influencing the markets in the middle of the cycle, and because you can never tell with any degree of certainty which of those influences will have the biggest impact.

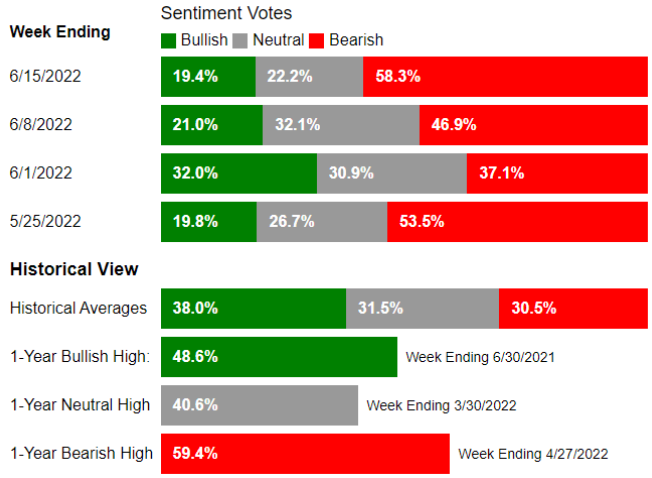
However, when markets are reaching extremes in euphoria or despair, and are thus likely within range of a market top or bottom, then the emotions of greed and fear tend to overwhelm everything else. In such environments, we believe that the ability to analyze and quantify these powerful emotions can provide valuable insight into the markets. Indeed, we believe that, at these extremes in euphoria and despair, markets can indeed "ring the bell", thus signifying a major and sustainable reversal in market trend.



Our experience is that this is particularly true regarding the measures of despair and capitulation that often accompany bear market bottoms, as investors tend to have a much more visceral and emotional reaction to losses than they do to gains.

If you combine this premise with our belief that large groups of people (i.e., a majority of market participants) tend to be subject to the oddities of crowd psychology, and thus will tend to respond to fear and greed in a similar and reasonably predictable way, then the idea of identifying major market tops and bottoms (or at least getting close) does not seem so farfetched.

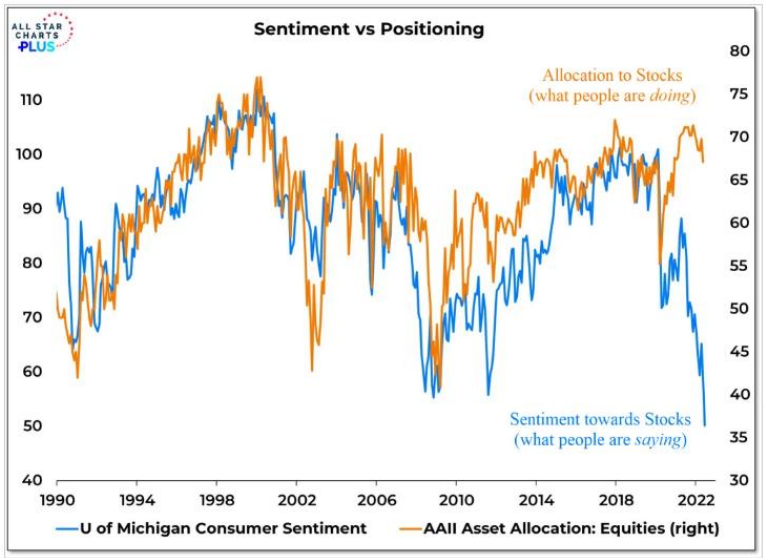
Some of those gauges of fear measure what investors say, while others measure what they do in their portfolios. That said, one important anomaly that seems to be rather unique to this particular bear market is that these measures currently contradict one another.



While current measures of investor sentiment illustrate the kind of extreme bearishness that often accompanies market bottoms, actual investor positioning still seems to reflect a belief that the Fed, as they have so often done in the past, will ultimately come riding to the market's rescue, once the decline gets severe enough, so all that you need to do is just hold on until the "cavalry" arrives.

As we have emphasized over recent months, we think that this opinion is misplaced, as anything that the Fed could do to aid the stock market would simultaneously exacerbate inflation, the reduction of which is the Fed's overwhelming priority.

Indeed, we suspect that markets are unlikely to see signs of broad capitulation, which we believe will ultimately be necessary for an end to this bear market, until investors (many of whom have never known an environment where the Fed did not act as a *de facto* safety net for the markets) recognize that the Fed is very unlikely to come to their rescue this time.



We think that it is this belief in the so-called "Fed put" that explains this divergence between the attitudinal sentiment measures, which are showing indications of capitulation, and the positioning and behavioral indicators, like the put/call ratio and VIX Index, which show that investor fear has yet to reach a point where most investors feel a need to hedge their risk or buy portfolio protection.

Indeed, from our perspective, these indicators of investor positioning (what are they doing versus what they are saying) continue to indicate an excess of optimism, a persistent and misguided belief in the "Fed Put", and a shortage of the kind of investor panic and/or capitulation that traditionally indicate a significant bottom.

Importantly, while capitulation occurs at most major bear market lows, there are certainly exceptions, although they suggest a very different type of bear market bottom, and one that demands a different investment strategy.

To explain, market tops and bottoms are effectively a tug-of-war between bulls and bears, as each camp battles for control of the market trend. In those relatively rare major market lows without a definitive signal of capitulation, the bottoming process can last many weeks, if not months, until bulls finally regain the upper hand. This is commonly referred to as a "saucer bottom" and, due to the lack of a definitive capitulation low, investors might be best served deploying any cash back into the equity markets over time and in stages, instead of trying to time the bottom.

In sharp contrast, when capitulation does take place, battle for control of the market trend is normally resolved in very short order, as the last potential sellers get washed out of the markets all at once in the final emotional decline, thus leaving the bulls in full control. With all of the potential sellers out of the way, it opens the door for a "V-Shaped" bottom and a powerful first leg of a new bull market. In such an instance, investors may be well served buying the market at or around the initial panic lows.

From our perspective, most signs support the idea that this bear market is growing very long-in-the-tooth and is already very technically oversold. The S&P 500 is also approaching a couple of areas of significant technical support, which we suspect will help to keep the market above its pre-pandemic highs.

In the meantime, we are still looking for signs of capitulation, and believe that, once it arrives, a market bottom could be "as clear as a bell".

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Definitions

The Standard & Poor's 500 (S&P 500) is a market-capitalization-weighted index of the 500 largest publicly-traded companies in the U.S with each stock's weight in the index proportionate to its market. It is not an exact list of the top 500 U.S. companies by market capitalization because there are other criteria to be included in the index.

The VIX Index is a calculation designed to produce a measure of constant, 30-day expected volatility of the U.S. stock market, derived from real-time, mid-quote prices of S&P 500® Index (SPX℠) call and put options. On a global basis, it is one of the most recognized measures of volatility -- widely reported by financial media and closely followed by a variety of market participants as a daily market indicator.

The CNN Fear and Greed Index (FGI) was developed by CNNMoney to measure two of the primary emotions that influence how much investors are willing to pay for stocks. It is based on the premise that excessive fear can result in stocks trading well below their intrinsic values, and that unbridled greed can result in stocks being bid up far above what they should be worth. CNN examines seven different factors to establish how much fear and greed there is in the market, scoring investor sentiment on a scale of 0 to 100.

The put-call ratio (PCR) is an indicator used by investors to gauge the outlook of the market. The ratio uses the volume of puts and calls over a determined time period on a market index to determine market sentiment. It can additionally be used for individual securities by looking at the volume of puts and calls on a security over a

determined time period. A high PCR is indicative of bearish sentiment while a low PCR is indicative of bullish sentiment.

Citations

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Image #2: "A Long-Term Perspective on Market Downturns" https://www.amgfunds.com/research-and-insights/keep-calm-and-remain-diversified/longterm_perspective_on_market_downturns/

Image #4: "What Happens After A Bear Market Starts? Four Things To Know", Ryan Detrick, Posted 05/23/2022, https://lplresearch.com/2022/05/23/what-happens-after-a-bear-market-starts-four-things-to-know/

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Image #7: "What Direction Do AAII Members Feel The Stock Market Will Be In The Next 6 Months?" www.aaii.com/sentimentsurvey

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