



Di Iorio Family Wealth of RBC Dominion Securities

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5 Factors We Believe Would Indicate a Market Bottom

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There are a few certainties in life, and predicting tops or bottoms in markets is not one of them. We've written in the past that timing the market is futile, and making decisions based on emotions is even worse. This is why we default to using methodology to help govern our decision making (check out [Our Methodology – The DM5](#)). Part of this methodology is systemizing processes as much as possible, one of the best examples of which is [Our Position Scoring System](#), which we use when deciding to add or reduce exposure to different assets.

Why would we then bother dedicating a post to predicting price movement, when all of the evidence points to this being ineffective? Because it is the question we are receiving the most from our clients given the current market environment. The second rule of The DM5 is "Document everything, especially mistakes rule." That means we have records of past periods which were very similar to what we are seeing today. Using history as a guide, we believe that we can learn from the experiences and mistakes of the past to better navigate the present.

On that note, here are five things we believe will be indicative of a bottom to the current market pullback:

1. Selling exhaustion

Markets bottom quietly, and usually do not recover in a V-shape. In 2008, the most severe market downturn in recent memory, stocks bottomed when there were essentially no sellers left. This was evidenced by the following: stocks continuing to trend downwards, but doing so with lower volatility (as measured by the VIX). So far this year, the market has been seeing swings of a 1% to 2%+ regularly; we believe that these will subside as the market eventually bottoms and begins to turn higher.

2. Rates must rise

The Fed has been talking about raising short-term interest rates for months, but “liftoff” only occurred last week. However, much of the market has been reacting to the anticipated rate hikes well in advance. It is important to remember that the market is a voting / predicting machine, and the activity that occurs today is really based on predictions of what will occur over the next 6-12 months. Much of the recent volatility has been caused by fears of rising inflation and the necessary changes to monetary policy that will ensue to get it under control. We believe now that the Fed has officially embarked on the path towards regaining price stability, the slow removal of uncertainty will be beneficial to the market going forward.

3. Inflation must fall

We’ve discussed inflation often in recent months, and how it measures year-over-year price changes (ie. not absolute levels). We believe that we will see inflation numbers begin to ease as the higher “base rate” takes effect. We also believe that supply-side constraints will begin to ease, though this has certainly been set back by ongoing geopolitical turmoil. We are watching prices of things like used cars very closely (one of the largest drivers of recent inflation), as well as how the ongoing disruptions to commodity prices progress.

4. Sentiment must be very bearish

We discussed investor sentiment in our last Webcast. History has shown that when investors are the most negative, the forward market returns over the coming months tends to be very positive. We reviewed how current levels of pessimism are in-line or worse than recent market inflection points (ex. 2016, 2018, 2020, etc.).

5. Bad news must be abound, and good news scarce

When stocks bottomed in 2020, after the onset of the pandemic, we were still at a point where we had no idea what the future would hold. Businesses were closed, economies were mostly shut-down, and repercussions on government debt were largely unknown. There was no clear path forward, yet stocks bottomed six months before the first vaccine was even announced. Today, we are faced with a very different situation, but uncertainties are still extremely high. However, from a market perspective, these uncertainties do not need to be resolved for the environment to improve (just like they didn’t in 2020). Stocks can go up before wars are over, before inflation is gone, and before interest rates stop increasing - so long as we have reached a point where the negatives have priced themselves in.

We have no idea when markets will bottom. However, using methodology and past experiences, we do believe that some of the factors needed for this to occur have begun to materialize.

One thing is certain, we will only know after the fact the point at which stocks were a screaming buy. So in the meantime, we will use the current negativity to our advantage by upgrading our holdings (like we did in 2020), and we will systematically put cash held on the sidelines to work.

As always, feel free to reach out to us directly if you'd like more insight, and feel free to share our thoughts with friends and family.

Sincerely,
Di Iorio Family Wealth

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