Zacks Confidential Commentary

History Has the Bulls Smiling at the Rest of 2022

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The first half of 2022 was the worst since 1970.

High inflation, and what that will mean for interest rates and the economy, had investors pricing in the worst.

But interestingly enough, we've been here before.

Not only did we see stocks surge by 27% in the back half of 1970 (also a year of high inflation), statistics show that periods of sharp declines in the first half, often leads to sharp rallies in the second half.

Brian Hayes, in this week's piece, gives a historical look at the similarities between this year's dramatic first-half drop, and the 5 worst first-half drops that came before it. You'll learn that high inflation isn't the only thing these periods have in common. And he'll show how the back half of these periods soared.

Moreover, he'll highlight one sector, in particular, that's beating the market right now, along with three stocks shaping up to be leaders in that group.

Enjoy,

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By **Bryan Hayes**
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"History rarely repeats itself, but it often rhymes." – Mark Twain

It's certainly been a year for the history books, as concerns over heightened inflation, slower earnings growth, and a potential recession have weighed heavily on risk assets. While this market has been difficult to navigate for even the most seasoned investor, using history as our guide can help us determine what to expect moving forward.

Having a plan in place that takes into account multiple outcomes can give us the confidence to tackle this dynamic market. It is this unbiased, flexible approach that we will use to determine the most likely path forward during the second half of the year. Let's begin by taking a step back and reviewing the events of the year thus far.

Learning from the Past – A History Lesson

In the first half, the Nasdaq fell more than 31% from its November peak and plunged 29.5% through June. It was the tech-heavy index's worst first half on record. The H1 statistics were only a tad better for the S&P 500, which ended 20.6% lower for its worst start to a year since 1970. The Dow slipped 15.3% during the first six months, marking its worst first half since 1962.

These statistics paint a gloomy picture, but history shows us not to worry. Illustrated below is an image portraying the worst 5 first halves for the S&P 500 alongside this year. As we can see, the average return during the following 6 months for stocks was 23.7% in these years. Just when everyone is starting to feel ultra-bearish may turn out to be a great time to buy. Only time will tell, but we know one thing about the stock market that has been shown time and time again – *markets have a way of proving the majority wrong.*

Date	YTD Return	Rest of Year
6/30/1932	-45.4%	56.2%
6/30/1939	-17.4%	14.7%
6/28/1940	-19.9%	6.0%
6/29/1962	-23.5%	15.3%
6/30/1970	-21.0%	26.5%
6/30/2022	-20.6%	?
Average		23.7%
Median		15.3%
% Higher		100.0%

Image Source: Zacks Investment Research

As part of our historical analysis, we tracked past years dating all the way back to the 1940s that had much in common with the current year. One of the main inputs in this analysis was that each of the years was a midterm year, just like 2022. The historical years also had at least one factor in common with this year, such as high inflation, slower earnings growth or a negative GDP print (such as the one we had in the first quarter).

There were two years that stood out to us and seem to be tracking the returns of 2022 quite strikingly. These years are 1962 and 1970. Shown below are the annual returns during each of these years. Notice how in 1962, the S&P 500 bottomed in June after a brutal start to the year. A rally ensued from late June to late August, when the bear reawakened. Stocks continued to fall into October before ultimately climbing higher over the holidays. The S&P 500 finished 1962 down 11.8% after having fallen roughly 26% earlier in the year.

Image Source: StockCharts

And in 1970, stocks found a bottom in late May – not too far off from the potential bottom in June of this year. Choppy action followed for a few months before a notable surge higher that reclaimed the lost ground. Stocks finished up 0.1% in 1970 after having declined approximately 25% during the first several months.

Image Source: StockCharts

While the chart of 2022 returns may seem bearish (shown below), keep in mind that the historical statistics are on our side. The market is a forward-looking mechanism, and it's *possible* that much of the slower earnings growth and declining economic activity that have been in the news headlines are already priced in. As previously stated, the S&P 500 ended the first half down 20.6%, and had fallen roughly 24% at one point in June.

Image Source: StockCharts

Looking to the Future

Are there any signs thus far in July that point to higher stock prices in the short-term? The answer is yes, as the release of June's CPI data this past Wednesday ended with higher stock prices to close out the week. This was in sharp contrast to May's CPI release that came out in June, which coincided with a large gap down in the midst of a leg lower for stocks. Each inflation print came in hot and were both 40-year highs, a sign that inflation hadn't yet officially peaked in June.

But it appears stocks have found support at an important level and are taking this most recent higher inflation reading in stride. Maybe market participants found some positives in the report, signaling potential signs of inflation peaking. Or maybe selling pressure has become exhausted. Either way, the market's reaction is noticeably different than the prior month.

We've established that better-than-expected outcomes are a possibility for the second half of 2022. If the rest of this year turns out to be bullish, how do we go about selecting stocks for our portfolio? We let the market guide us in our selection process, and we employ the various Zacks Ranking Systems to help us identify stocks with the best profit potential.

Putting It All Together – Leaders Lead

If the low in June turns out to have indeed marked a true market bottom, June 16th will go down as the date of the closing low in price for the S&P 500.