Bloomberg

Opinion

Points of Return

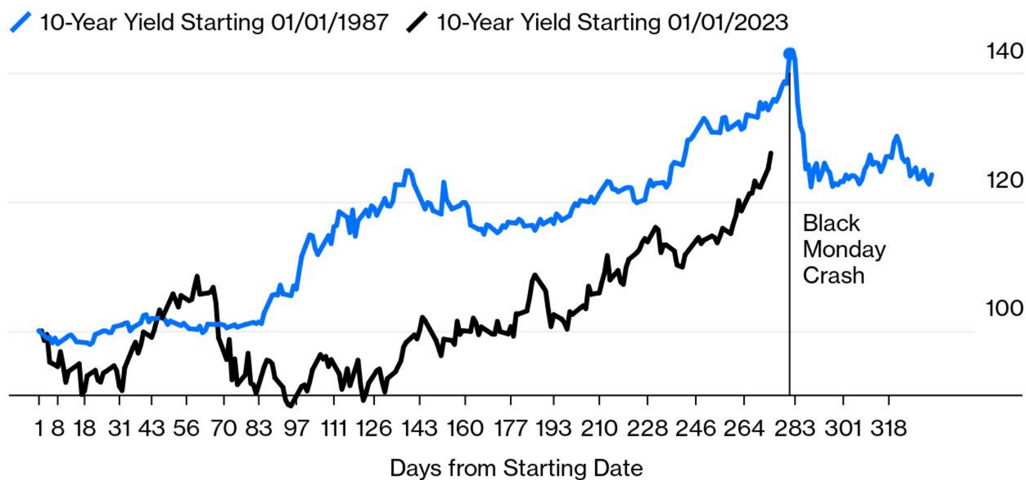
by John Authers

1987 And All That

In financial circles, comparisons to 1987 are never welcome. The Black Monday crash in October of that year is still the single most terrifying day in market history; any suggestion that current circumstances are at all like the early months of 1987 is a little scary. So it's disconcerting to find three references to that inauspicious year in my email inbox.

True, one is from Albert Edwards, the long-time very bearish investment strategist of SocGen. But he's not the only one to see something reminiscent of 1987 in 2023's rally for equities even as bond yields rose. "When I started in the business in 1987," reminisces Steve Sosnick of Interactive Brokers, "bonds were mired in a bear market for most of the year while stocks rallied sharply. Until, of course, that reversed quickly."

To illustrate just how quickly yields reversed on Oct. 19 when the stock market tanked 20%, and how similar it looks to 2023, here's an overlay chart of the percentage increase in the 10-year yield from the start of each year:

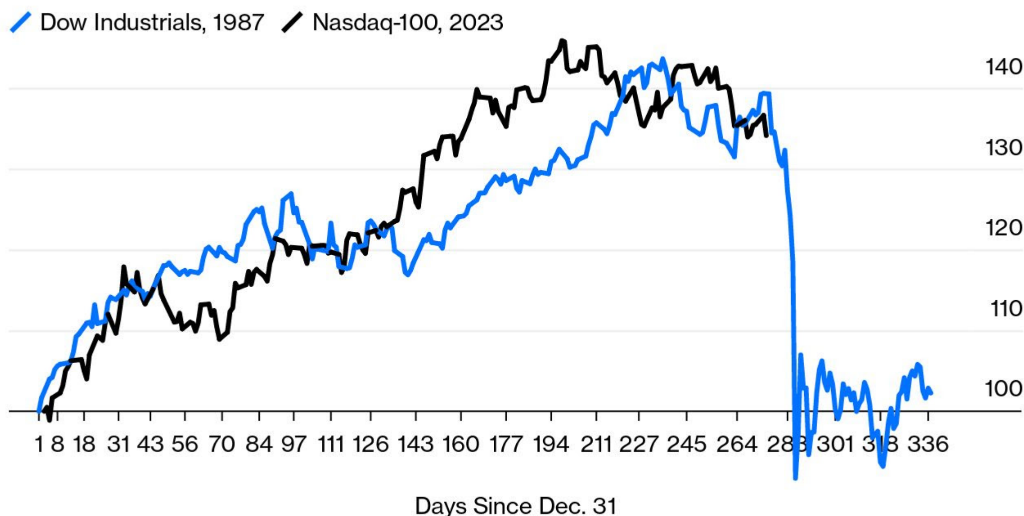


Chris Verrone of Strategas Research Partners sees "shades of 1987." Treating Sept. 20 (when Jerome Powell surprised the market with his hawkishness after an Federal Open Market Committee meeting) as a "breakout day" analogous to Aug. 27, 1987, when yields broke upward, he calculates that they peaked 33 trading days later on Oct. 15 at 10.23%. Today, he says, "that would be the equivalent of roughly 5% on the 10-year by early November."

As for Edwards, he said:

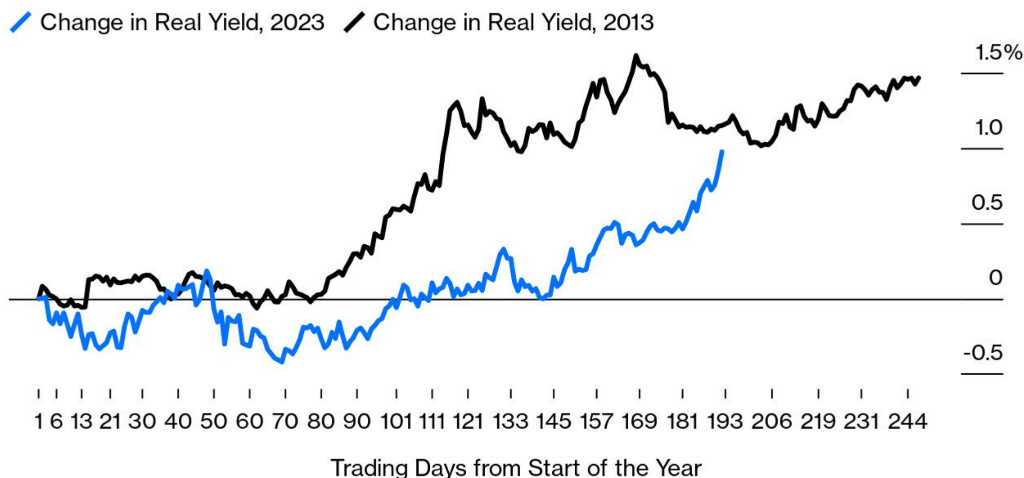
> *The equity market's current resilience in the face of rising bond yields reminds me very much of events in 1987, when equity investors' bullishness was eventually squashed. And in a further parallel, currency turbulence in 1987 played a key role in exacerbating recession worries for an equity market priced for the start of a new economic cycle. Just like in 1987, any hint of recession now would surely be a devastating blow to equities.*

For more horror chart porn, we can move on to equities. This is how the Nasdaq-100 has fared so far this year, compared with how the Dow Industrials did from the beginning of 1987. This is normalized; there's no trickery with double scales or anything:



Should anyone deploy any money on the basis of overlay charts like this? Of course not. The illustration above does not prove that the Nasdaq will crash next Monday. Starting points for these charts are arbitrary, and all other conditions may not be the same. That said, they can spook people. Particularly when, as now, stocks have run into trouble. Ahead of Black Monday in 1987, versions of the following chart were circulating on Wall Street. One line shows the Dow Industrials starting on Halloween 1986, while the other is the Dow starting on Halloween 1928. Again, they're indexed:

If all this suggests that the equity market will soon inevitably collapse under its own contradictions, I now have a counter-example. This year's rise in real yields is phenomenal, and is now fully comparable to the Taper Tantrum of 2013, when the bond market fell out of bed at the merest hint from the Federal Reserve that it might slowly start to buy slightly fewer bonds each month. At this stage, the 10-year TIPS yield has gained almost exactly as much as it had by the same point in 2013:

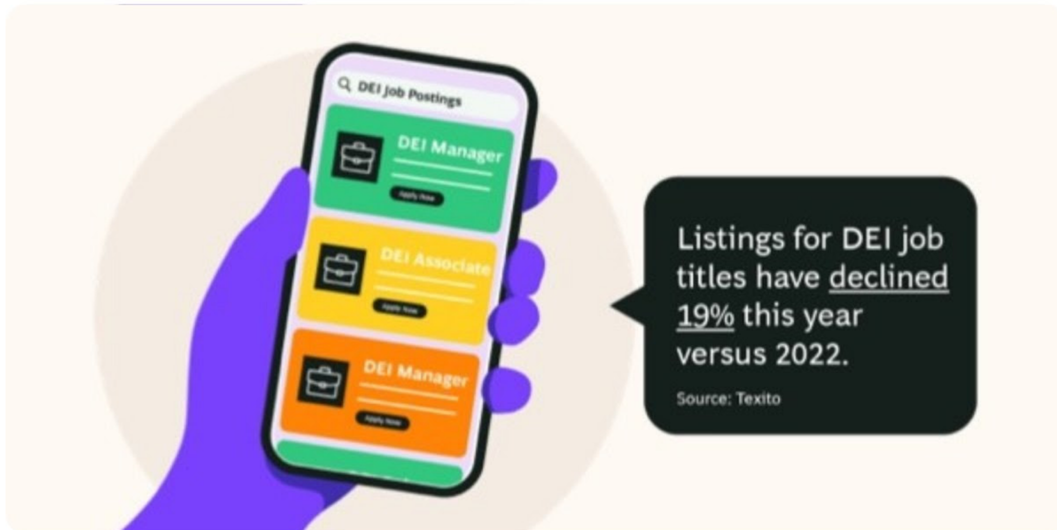


Note that we are now at the point when the first tantrum began to calm down. That was mainly because the Fed decided not to taper its bond purchases in September 2013, to widespread relief and surprise, and instead waited another three months. The lesson from this analogy would be that a spike in yields this dramatic must surely push the monetary authorities into being more lenient.

The lesson from all these charts is that it is indeed very unusual for stocks to perform so well when bonds are having such a bad time. It's reasonable to expect that something will give soon. It doesn't necessarily have to involve a stock market crash.

A MESSAGE FROM BOSTON CONSULTING GROUP

Why DEI Investment Is Critical During Turbulent Times



Many organizations are sacrificing long-term growth by cutting DEI investments, but research shows it's a short-sighted business move. Investing in DEI and employee-centric programs yields tangible returns and dramatically improves employee inclusion.

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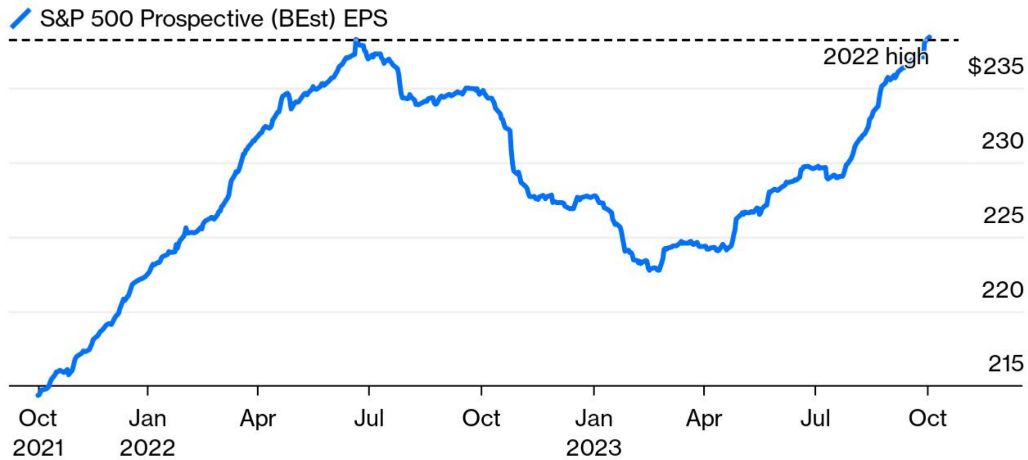
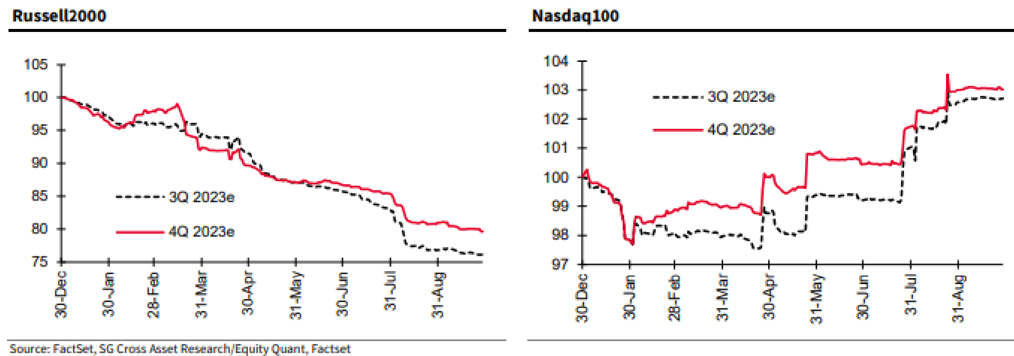
BCG's BLISS INDEX

Earnings

If you want a good reason why stocks won't crash, it might come from corporate earnings, which in the US are expected to be rosy. Indeed, it's as though the high inflation, rising interest rates and disappointing Chinese reopening of the last 18 months never happened. As of this week, expected 2023 earnings per share for the S&P 500, as calculated by Bloomberg, topped the peak it made in June 2022:



Note, however, that the optimism is not in any way uniform. As the following chart from Societe Generale SA's chief quantitative strategist Andrew Lapthorne shows, earnings expectations have risen steadily for the Nasdaq-100, dominated by mega-cap technology groups, even as they have plummeted for the small caps in the Russell 2000, for whom third-quarter forecasts are now almost 25% lower than at the start of the year:

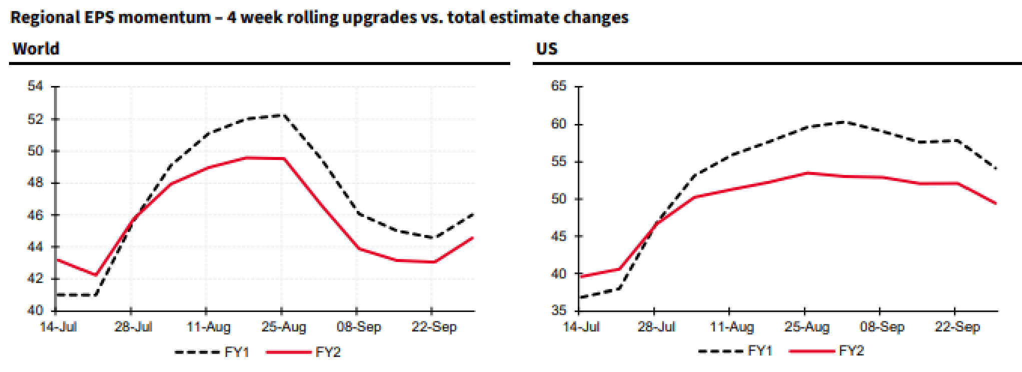


Executives themselves seem more comfortable in guiding the Street after three pandemic-distorted years when many opted to stay silent ahead of the results. That said, the greater clarity is not necessarily a good thing, as many are thinking negatively. Of the 115 S&P 500 companies that have given guidance — the highest total number since the first quarter of 2020 — around 24% have revised their projections upwards in contrast to the 39% that changed their projections lower, according to Bloomberg Intelligence.

This is why BI's Wendy Soong expects the reporting season not to be "too bullish" since the company guidance momentum, which basically takes the number of companies who revised upwards minus those that changed lower, is positive. "The predictions for the second half of 2023 ease earnings recession concerns to resumption of growth," said Soong, who added that estimates also saw moderate growth into 2026.

According to the count kept by SocGen's Lapthorne, US earnings momentum has cooled in the last few weeks, although a slight majority of revisions are still positive. Globally,

momentum remains weak — and it's also notable that companies are more likely to downgrade estimates for 2024 than for this year, possibly a result of the increasing belief that rates will be "higher for longer":



To Raphael Thuin, head of capital markets strategies at Tikehau Capital, the consensus is too optimistic. "People are estimating the economy will rebound and that we won't have a recession. That's too optimistic. You don't need a crystal ball. There is a liquidity risk," he said, referring to the decreasing money supply, or M2. "The consumer is exhausted. There is rising credit card debt."

Certainly, the latest Fed study of household finances shows that Americans outside the wealthiest 20% have run out of extra savings and now have less cash on hand than they did when the pandemic began. For the bottom 80% of households by income, bank deposits and other liquid assets were lower in June this year than in March 2020, after adjustment for inflation.

Even so, a recession, according to Tikehau's Thuin, is still on the table as the lagged effects of the Fed's aggressive monetary tightening finally trickle in. "The estimate is 12 to 24 months," he said, referring to how long it usually takes for the rate hikes to hit the economy; the Fed started to raise the fed funds rate 18 months ago. "It's exactly now. We are starting to see some effects."

To Stuart Kaiser, Citigroup head of US equity trading strategy, the earnings season is more of a "wildcard." He said he expects a repeat of the second quarter, which was "neutral at best for equities given a higher bar. The positive case would be companies follow the Fed and revise up 2024 numbers that have proved too conservative," he added. "The negative case revolves around margin pressure as the revenue growth from higher prices is no longer able to offset input and labor costs."

Nicholas Colas, co-founder at DataTrek Research, also doubts the upcoming earnings season can provide much of a catalyst for stocks. He points out that 69% of S&P 500 tech companies have given guidance, compared to just 16% of non-tech companies. "When management puts their reputation on the line with markets by projecting future earnings, it gives investors incremental comfort that they will not be disappointed when numbers are released," Colas said. "This both dampens stock price volatility and increases valuations."