BRINKER CAPITAL INVESTMENTS

APRIL 13, 2020

Brinker Capital Bear Market Bottom Checklist

We checked off our Market Structure box as we continue to see fewer individual stocks trading to new lows, which follows closely on our checking off the Policy Response box to reflect passage of the $2.1 trillion COVID-19 rescue package by the Federal Government.

Fiscal policy has now engaged with monetary policy in an unprecedented effort to contain the economic impact of COVID-19. The Policy Response box includes an asterisk (*), because our country and economy have never faced a threat quite like the COVID-19 pandemic, and we don't know if the policy response will prove equal to the challenge at hand. There are also questions as to how quickly the Federal Government will be able to get aid to the states, industries, and workers most impacted by COVID-19. The asterisk continues to reflect those uncertainties. That said, most boxes have been checked off on our Bear Market Bottom Checklist, and we believe we have seen the lows for this market cycle. As such, we have been opportunistically adding to risk and positioning our portfolios to perform well in a more benign market environment. Going forward, we would see market drawdowns—all else being equal—as opportunities to further increase our exposure to risk assets.

The Brinker Capital Bear Market Bottom Checklist references the end of the 2002/2003 and 2008/2009 downturns to determine if we are near or at the end of the current bear market. History may not repeat but it rhymes, and market history tells us much of the bad economic news has already been priced into the market.

Our checklist is composed of eight factors.

1. **Investor sentiment**
   Investor sentiment reaches an extreme bearish point at a market bottom, with the number of market bears outnumbering the number of market bulls, and the number of bulls falling under 30%, in the Investors Intelligence Survey.
2. **Volatility**
   Market volatility spikes through a market downturn, and extreme moves historically happen at a bear market bottom.
3. **Credit spreads**
   High-yield credit spreads widen out dramatically at a bear market bottom as investors price in a wave of expected defaults. This exceptional widening of spreads represents a level of fear and pessimism historically commensurate with a bear market bottom.
4. **Yield curve**
   The US Yield Curve historically steepens at a bear market bottom. From an economic perspective, it indicates we are in a recession (though we don't yet know it as the economic data hasn't caught up with the deteriorating economic environment), while from a stock market perspective it indicates equities have already priced in the downturn (recall that the stock market is forward-looking and will move higher or lower ahead of the economic data).
5. **Peak to trough correction**
   The average peak to trough correction during the 11 bear markets since 1946 was approximately 30%.
6. **Fund flow data**
   Investors almost indiscriminately sell out of US stocks at a bear market bottom. As such, we have seen meaningful outflows from US equity facing mutual funds at prior bottoms.
7. **Market structure**
   The underlying structure of the market can indicate we are near or at a bottom. More specifically, we see a contraction in the number of stocks making new lows, while the market continues to make new lows.
8. **Policy response**
   Historically it has taken a meaningful policy response on the monetary front (the US Federal Reserve) and the fiscal front (the US Federal Government) to put a floor under investor sentiment and risk assets. Those policy responses also set the stage for a reacceleration in economic growth.

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	2002/03	2008/09	2020	Current environment
Investor sentiment: Investors Intelligence Survey % bears > % bulls with bulls < 30%	●	●	●	In the most recent survey, bears outnumbered bulls 42% to 30%.
Volatility: VIX measure of volatility reaches extreme level	●	●	●	VIX hit a record-high level of 85 on March 16
Credit spreads: Significant widening of credit spreads pricing in a wave of corporate defaults	●	●		High-yield spreads have widened meaningfully, but not yet reached levels seen in the financial crisis
Yield curve: Yield curve steepens	●	●	●	Spread between the 10 Yr and 2 Yr Treasury widened 30bps in March
Peak to trough correction: Average decline of 30% during 11 bear markets since 1946	●	●	●	S&P 500 Index has declined -32% from the February 19 high
Fund flow data: Indiscriminate, panic selling of equity funds/ETFs	●	●	●	Investors have fled equities in March, with outflows from US equity funds of $17 billion
Market structure: Contraction in the number of stocks making new lows	●	●	●	The number of stocks making new lows peaked in late March, and has continued to decline in April
Policy response: Meaningful fiscal and monetary policy response	●	●	●*	*The Fed and Federal Government are engaged; will it be enough to offset the impact of COVID-19?

Source: Brinker Capital

Based on our analysis, several factors pointing to a bear market bottom are in place; however, we need to see more. Our team will continue to monitor the dataset above and keep you all informed of what we see, what we think, and when we believe US equities have bottomed out and are poised to move higher. A final point worth remembering is that risk assets will inflect higher before the economy inflects higher.

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Index definitions: S&P 500 Index - Widely regarded as the best single gauge of large cap US equities. The index includes 500 leading companies and captures approximately 80% coverage of available market capitalization. Volatility Index (VIX) - A real-time market index that represents the market's expectation of 30-day forward-looking volatility. Derived from the price inputs of the S&P 500 index options, it provides a measure of market risk and investors' sentiments. One cannot invest directly in an index.