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Commentary

November 23, 2026

S&P 500 Falls into Correction, but Signs of a Bottom Are Emerging

- Seven straight losses pushed the S&P 500 into correction territory.
- Extremely pessimistic sentiment is a classic contrarian sign of capitulation and a potential bottom.
- We view this correction as a buying opportunity for long-term investors.

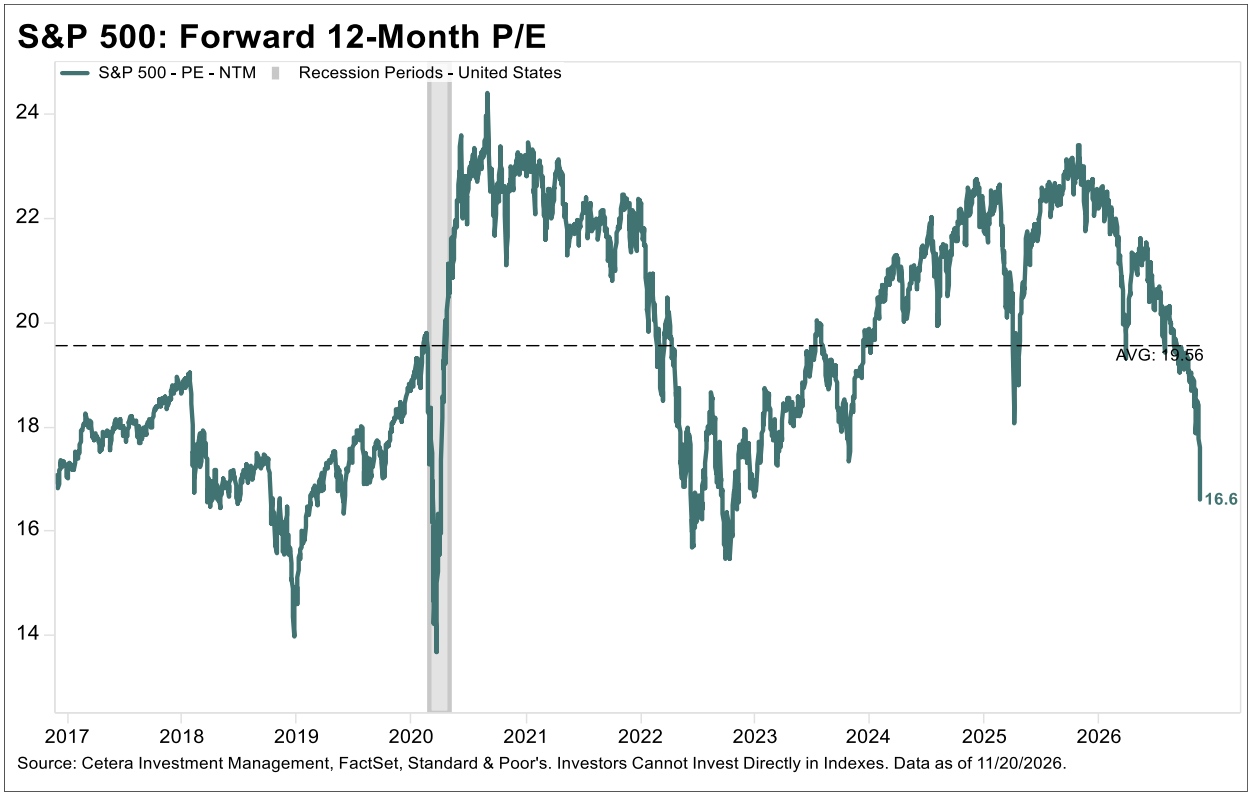
The S&P 500 fell 3.7% on Friday, its seventh consecutive losing session and the longest streak since February 2020. The index is now nearly 12% below its October 6 record high, which puts it in correction territory and leaves it about flat for the year. The VIX, a measure of volatility, rose above 35, its highest level since March, while Treasuries and the U.S. dollar rallied on safe-haven demand. The main driver is a repricing of the AI trade, amid worries of capital and regulatory constraints and that capex and earnings growth have peaked. Hawkish Fed rhetoric and rising Middle East tensions added to the selling pressure.

Investor sentiment has turned pessimistic, which is often a contrarian indicator and a classic sign of capitulation and a potential bottom. Several indicators that have historically been associated with market lows may have emerged on Friday:

- Fear is elevated. Readings above 35 on the VIX signal real stress, and they have often coincided with, or come just before, market lows.
- Drastic single-day market moves in leaders. Major market leaders saw their shares fall double-digits on Friday. Outsized one-day drops in crowded leaders often reflect forced selling rather than new information.
- Selling looks indiscriminate. Gold suffered sizeable losses alongside stocks, a sign of broad liquidation that often marks the exhaustion of forced selling.
- Bad news is priced in. Chip stocks are pricing in a lot of bad news, including new export license rules, short reports and financing worries, and the multiple contraction potentially implies negative earnings growth.
- Rotation rather than liquidation. Despite the indiscriminate selling previously discussed, it was noteworthy that on Friday the Dow and S&P 500 outperformed the technology-heavy Nasdaq Composite, while the equal-weight S&P 500 index fell less than the market cap S&P 500. This is a sign that investors are still willing to own stocks, just not those related to AI and technology. It suggests the damage may be contained to one theme rather than spreading to the whole market, which is typical of a correction and not of the start of a bear market.
- Pressure valves are opening. Year-ahead inflation expectations fell to 3.7% from 4.7%, many commodities have pulled back, and the 10-year Treasury yield fell to 4.93%. The Fed may not need to raise interest rates as much as markets fear.

Bottoms are only clear in hindsight, so we are not calling the exact low. We would look for the VIX to roll over, for bad headlines to stop producing new lows, and for market breadth to improve.

We see this correction as a buying opportunity for a few reasons. First, the economy is holding up with the labor market growing at a steady pace and consumer spending continuing to be solid. Sharp declines, or bear markets, are typically tied to recessions, and we don't see one in the immediate future. Without a recession, corrections tend to be shorter and shallower. The only caveat is if growth data keeps softening and the Fed keeps tightening, which could possibly change the picture. Second, earnings growth still looks healthy, including Factset estimating Q4 2026 and 2027 earnings growth of 28.6% and 16.5% respectively. Third, about $28 trillion sits in money market funds and bank deposits. If stocks slide a lot, that cash from the sidelines could get invested. Fourth, looking at the chart, valuations are attractive if earnings growth expectations are realized with the S&P 500 forward P/E ratio below five- and 10-year averages and trading at levels not seen since the 2022 bear market. Market leadership has also been broadening. Lastly, we don't read the midterm results as a referendum on AI, which was an early trigger of the current AI ecosystem scrutiny. Data center construction may slow, but AI's economic gains come from adoption across the economy. Markets may even welcome a slower pace of spending given recent announcements of bigger spending plans, or the debt and stock issuance to fund them, has not been embraced by investors over the past few months. Slower spending could also take some pressure off inflation.



We expect more volatility, but we don't anticipate a severe bear market. Corrections are a normal part of investing and can arrive quickly, but during bull markets tend to be short-lived. Reacting emotionally to short-term swings can turn a temporary decline into a permanent loss. Stay focused on your goals and time horizon while maintaining a diversified portfolio to meet them. Your Cetera financial professional can help you stay focused and prepared.

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