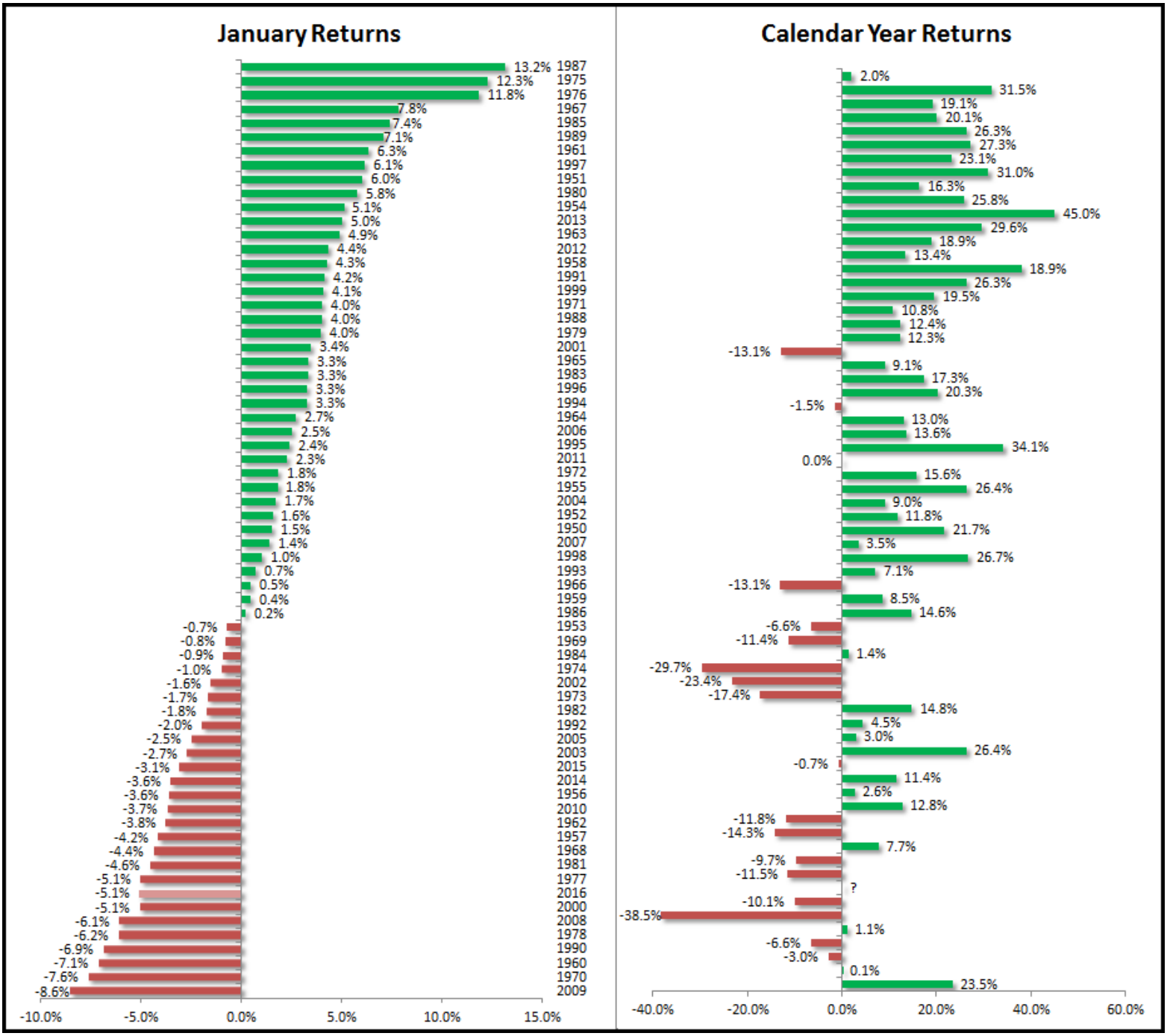
Monday February 1, 2016

The January Barometer

The old market adage warns, "as January goes, so goes the year"; the idea of course being that if the first month of the year records a gain, the year will follow suit on a positive note. Unfortunately, for those who follow the old market adage, January 2016 ended on the negative side. The market, as defined by the S&P 500 SPX, closed the month of January down -5.07%, the 7th worst January since 1950 (there is a three way tie for 7th place). It also marked the third consecutive year that the SPX ended the first month of the year in the red, as 2014 and 2015 saw the market decline -3.6% and -3.1%, respectively. With a negative January, the old market adage implies the overall year will leave investors loss stricken as well. There is research to support this historical bias and using data going back to 1950 (as published by Stock Trader's Almanac), this barometer is "right" about 75% of the time, and "really wrong" just 12% of the time (the market moves 5%, or more, in the opposite direction as January). In years in which January is up, the S&P 500 manages an average return of +16.8% for the year, versus -3.3% in years starting with a down January.

Since 1950, there have been 8 of those "really wrong" years for the S&P 500, where it has moved more than 5% in the opposite direction of how the month of January closed. Interestingly, 3 of those 8 years where the barometer has been "broken," came within the past decade and one of them was last year. In January 2009, we started the year much like 2008 ended, with a loss of -8.6%. But after a March bottom, the market got back on solid footing and ended the year with huge gains of +23.5%. In 2010, we entered the year with a -3.70% return in the S&P 500, yet the rest of the year was quite positive and ended up +12.78%. IN 2014, the market stumbled out of the gate, falling more than 3% in January, only to turn around and finish the year with double-digit gains. So there have been 3 "really wrong" years for the January Barometer within the past decade, but over time the adage has its roots in being right far more often than it is wrong.

The image below depicts the past 66 years of data for the January Barometer. Notice how the general bias is towards positive returns following positive Januaries, while negative annual returns have been far more frequent after a negative January return.



Relevant January Barometer Market Stats

- Since 1950, when the S&P 500 SPX records a gain in January, it has recorded a gain for the full year 90% of the time (36 out of 40).
- When January is a positive month, the SPX has average annual returns of +16.84% for the full calendar year.
- When the S&P 500 is down in the month of January, it has finished down for the full calendar year 54% of the time (14 out of 26).
- When January is a negative month, the SPX has average annual returns of -3.29% for the full calendar year.

A point that bears repeating, however, is that the “January Barometer” has been far better at predicting strong years than has been the case in predicting losers. Of the 26 "down" Januaries since 1950 (not including 2016) the market has followed up with down years 54% of the time (14 occurrences). There have been 5 double-digit rallies following a bad month of January (2014, 2010 and

2009 being the more recent examples). These historical tendencies are just that, tendencies, and can obviously be wrong and shouldn't serve as a primary indicator for anyone looking to tactically manage market risk. This actually brings us to another observation regarding the tendencies of January, as historically the year's leadership groups are often unsheathed by their January returns. Research first provided by Sam Stovall at S&P Outlook found January returns to be a particularly good sector rotation tool. Here are some of the highlights from his research on the topic a few years back, as well as some points from The Stock Trader's Almanac:

Relevant January Barometer Sector Stats

- Using data from 1970 thru 2010 shows that the Top 10 performing S&P 500 sub-sectors for the month of January tended to consistently outperform the Index for the next 11 months (February thru December) and 12 months (February thru January of next year); and performed even better in years when January was up.
- Not only does this "January Portfolio" outperform the S&P 500 consistently, but it outperforms similar portfolios from every other month of the year, as well.
- The top 10 performing sectors from January had average 11-month returns of 14.3% as a portfolio (from 1970 to 2011), while the S&P 500 showed average gains of +6.7% during the next eleven months.
- From 1970 through 2011, the top 10 performing sectors in January outperform the S&P 500 Index 69% of the time as a portfolio.
- When the S&P 500 is up in January, the top-ten industries "January Portfolio" the average portfolio gain rises to 18.6%, compared to 11.8% for the S&P 500, thru 2011.

(Source: Stock Trader's Almanac. Also other information can be obtained at www.marketscope.com, "Sam's Sector Watch." and the "January Barometer Portfolio" from S&P Capital IQ Global Equity Research Sector Watch.)

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