LPL RESEARCH
WEEKLY MARKET COMMENTARY

KEY TAKEAWAYS

The stock market fell in January, causing some to ask whether the so-called January effect means that stocks will fall this year.

Recall less than four weeks ago the "first five days" indicator sent a positive stock market signal for 2015.

We always put fundamentals first when forecasting stock market direction—and on that score, we believe stocks still look good.

February 2 2015

DON'T FRET ABOUT JANUARY EFFECT

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The stock market declined in January 2015, causing some to ask whether the so-called January effect (or what some call the January barometer) means that stocks will fall this year. One of the best known Wall Street adages, "as January goes, so goes the year," has a good track record when January is positive, but it is mixed otherwise. Although we always put fundamentals first in trying to forecast market direction, in this commentary we look at January market patterns and posit that the January dip may not be a reason to fret about the stock market in 2015.

> The so-called January effect, or January barometer, has a strong track record in that positive Januaries for the S&P 500 have preceded positive years 90% of the time since 1950, with an average calendar year gain of 16.9%.

MIXED TRACK RECORD FOR JANUARY EFFECT

The so-called January effect, or January barometer, has a strong track record in that positive Januaries for the S&P 500 have preceded positive years 90% of the time since 1950, with an average calendar year gain of 16.9%. In addition, the average calendar year gain in the S&P 500 when January is positive far exceeds the average move during years when stocks fall in January (-3.4%). But the indicator's batting average following down Januaries—such as we just experienced—is mixed over the past six-plus decades [Figure 1]. A January stock market decline has preceded a down year just 56% of the time—not much different than a coin flip. More recently, during the past 10 years, this pattern has only held 50% of the time, including failures during 2009, 2010, and, importantly, 2014, when the S&P 500 was down in January and finished firmly positive by year-end.

The S&P 500 also fell in December 2014. So what does a down December and January mean for the stock market? The results are similar. While the S&P 500 is marginally lower, on average, for a calendar year when the preceding December and January of that year are both negative, the batting average in the eight occurrences since 1950 is just 50%.

The key takeaway from this exercise is that although down months in January may reduce the probability that the S&P 500 will rise in 2015, based on the historical data, the numbers still suggest a roughly 50% probability of a gain. And while the

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90% odds of an up year after a positive January may look like a missed opportunity, the odds of an up year if the U.S. economy does not enter recession are 82%, based on data back to 1950. We still consider that scenario may be likely and continue to expect a high-single-digit gain for stocks in 2015.*

HOW QUICKLY WE FORGET: THE FIRST FIVE DAYS OF JANUARY WERE UP

Although the focus right now is on the January decline, it was less than four weeks ago when a positive 2015 signal from the "first five days" indicator was issued. Another widely cited Wall Street adage, gains during the first five trading days of the year have done a fairly good job signaling positive years for stocks over time. The last 41 times that the first five days of January were up for the S&P 500, that calendar year saw gains 35 times—a batting average of 85%, with an average gain of 14% [Figure 1]. The more superstitious among us who follow these patterns can take some comfort in that one (and it took back-to-back gains over 1% on days four and five to turn this one positive last month). But before you base your investment strategy on this indicator, keep in mind that the S&P 500 still managed to rise 54% of the time, even when the S&P 500 was down over the first five days of the year.

*Historically since WWII, the average annual gain on stocks has been 7–9%. Thus, our forecast is in-line with average stock market growth. We forecast a 5–9% gain, including dividends, for U.S. stocks in 2015 as measured by the S&P 500. This gain is derived from earnings per share (EPS) for S&P 500 companies growing 5–10%. Earnings gains are supported by our expectation of improved global economic growth and stable profit margins in 2015.

FUNDAMENTALS FIRST

There are a host of other stock market indicators that market watchers bring up at this time of year, primarily to entertain. We have all heard about the Super Bowl indicator (last night's outcome was bearish for those of you wondering). Some look to Santa Claus, Groundhog Day, the Chinese New Year, "sell in May," and others. Although these indicators are fun to follow—especially for the more superstitious among us—they are essentially random, with no basis in

1 JANUARY EFFECT SENDING MIXED SIGNALS FOR 2015

	Batting Average with Positive Signal	Average Gain/Loss	Batting Average with Negative Signal	Average Gain/Loss	Effective Rate	Signal for 2015?
First Five Days	85%	14.0	54%	0.7	69%	+
January Effect	90%	16.9	44%	-3.4	78%	–

Source: LPL Financial Research, FactSet, 1/30/15

S&P 500 data from 1950–2014.

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fundamentals, and certainly should not be a meaningful part of anyone's investment process.

Fundamentals always come first, and on that score we believe the outlook for the stock market remains positive. Economic growth in the United States has been steady in recent months and should be supported in 2015 by lower gas prices. Job growth remains steady. Earnings growth is being weighed down by oil and the strong U.S. dollar but is still on pace for respectable mid-single-digit growth in Q4 2014. We believe our high-single-digit forecast for S&P 500 earnings growth in 2015 is still achievable, despite substantial declines expected in the oil patch. Stock valuations are above average, but when compared with opportunities in the bond market given low interest rates, we consider them quite reasonable. The Federal Reserve, European deflation, Greek politics, the oil and gas downturn, and terrorism all present risks, and volatility may rise in 2015, but stock market fundamentals still tell us to stick with stocks.

CONCLUSION

We continue to forecast 5–9% returns for the S&P 500 in 2015, as we stated in our *Outlook 2015* publication, based on market fundamentals, and do not think the January decline presents any cause for concern. We will always put fundamentals first when forecasting stock market direction—and on that score, we believe stocks still look good. ■

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The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. All performance referenced is historical and is no guarantee of future results.

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Because of its narrow focus, specialty sector investing, such as healthcare, financials, or energy, will be subject to greater volatility than investing more broadly across many sectors and companies.

Bonds are subject to market and interest rate risk if sold prior to maturity. Bond and bond mutual fund values and yields will decline as interest rates rise and bonds are subject to availability and change in price.

All investing involves risk including loss of principal.

INDEX DESCRIPTIONS

The Standard & Poor's 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

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RES 4977 0215 | Tracking #1-350149 (Exp. 01/16)

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