

# As Goes January, So Goes the Year?

If the old adage: "As goes January, so goes the year," comes to fruition in 2016, investors are in for a tumultuous ride. Last month extreme volatility dominated Wall Street leading to outsized losses for all three major U.S. equity indexes.

Opinions run rampant about what is causing the volatility -- and how it might play out over the remaining months of 2016.

The Dow Jones Industrial Average fell 5.5% for the month while the S&P 500 index topped 5.1% as both benchmarks experienced their worst four-day start to a year ever.<sup>1,2</sup> The NASDAQ Composite Index plunged 7.9%, marking its worst monthly performance since May 2010.<sup>1</sup> And it's not just U.S. stocks that are tanking. The contagion has afflicted many of the world's biggest stock markets, including those in the United Kingdom and Japan, both of which are now in bear market territory.<sup>3</sup>

Opinions run rampant about what is causing the volatility -- and how it might play out over the remaining months of 2016. While falling prices for oil and other commodities and China's economic slowdown are key factors on everyone's list, are these trends alone enough to drive falling global stock prices?

Some economists contend that in past periods when red flags emerged and markets experienced intense volatility, it was easier to identify the overarching cause. For instance, in 2011, markets plummeted over the potential collapse of the Eurozone; in 2008, it was over fears that the entire global financial system was in jeopardy; and in 2000 it was the bubble in technology stocks. But this time, there seems to be no singular event or trend rising to the surface.<sup>4</sup>

## Systemic Drivers

Let's dig a little deeper and look at some more systemic possibilities behind the tumult in the global markets. Some of the leading theories include the following:

Investor "herd" behavior. The current sell-off in global stocks may be partially attributed to the actions of global asset managers who purchased high-yield bonds, emerging market stocks, and energy investments during the market rally of 2009 to 2014 -- but who now are racing en masse to sell the same investments. This theory pins the drop in stock prices more on the psychology of investors than on any underlying conditions in the global economy.<sup>4</sup>

Trading technologies. The growing use of software trading technologies is making it more difficult to read what is driving market trends -- and is skewing buy-sell decisions toward short-term considerations. In an article for *The Washington Post*, former international equity trader Jonathan Aberman wrote, "Software that autonomously prices and executes trades across world markets is pervasive. In fact, observers suggest that a majority of trading in markets such as foreign exchanges, commodities, and equities is now undertaken by software."

He goes on to note that, "Most equity trading in the United States is also done by

software; the current average holding period of an equity share is five days -- that holding period used to be about eight years."<sup>5</sup>

Federal Reserve monetary policy. With its move to initiate an interest rate hiking cycle in December 2015, the Federal Reserve may now act as more of a headwind for the stock market than the tailwind it has been for many years through its multiple rounds of stimulus. The Fed's influence goes far beyond interest rates. It impacts stock valuations, corporate bond yields, and investors' appetite for risk.

### **Bear Market or Recession?**

So, as January goes, so goes the year? Is the January market rout signaling that a bear market and/or recession lies ahead? There is no definitive answer to that question, but history provides some insight.

According to S&P analyst Sam Stovall, since 1946 when the S&P was down in January, the full year ended down 56% of the time. And while down Januarys don't necessarily foreshadow bear markets (a drop in the market of more than 20%), for years when the S&P 500 plunged deeply in January -- 4.6% or more -- two out of three of those years ended with losses averaging 6.1%.<sup>6</sup>

In terms of recessions, Stovall's research indicates that since 1948, every recession in the United States has been preceded by a stock market decline. A decline of at least 10%, also referred to as a correction, occurred at least 7.5 months before the start of the recession.<sup>6</sup>

On the bright side, Stovall offers this: In January 2009, the S&P 500 lost 8.6%, the worst decline on record for the month. Yet, despite widespread fear about the recession and bear market, investors started bargain shopping in the stock market in March 2009 and stocks climbed sharply. By the end of the year, the S&P 500 had climbed over 23%; of course past performance cannot guarantee future results.<sup>6</sup>

<sup>1</sup>*CNN Money*, "Stocks: 4 things to know before the open," February 1, 2016.

<sup>2</sup>Reuters, "Dow, S&P off to worst four-day Jan start ever as China fears grow," January 7, 2016.

<sup>3</sup>*The Wall Street Journal*, "Markets' Panic Incongruent With Economic Reality -- For Now," January 20, 2016.

<sup>4</sup>*The New York Times*, "How to Make Sense of Plummeting Global Markets," January 20, 2016.

<sup>5</sup>*The Washington Post*, "Jonathan Aberman: Why so much market volatility tells us so little," February 1, 2016.

<sup>6</sup>*The Chicago Tribune*, "Bad January a bad omen for stocks in 2016?" January 31, 2016.