

Weekly Market Commentary



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Get Ready for Market Storm Angel

Jeffrey Kleintop, CFA

Chief Market Strategist
LPL Financial

Highlights

A year ago, The Weather Channel decided it would start naming winter storms in an effort to raise awareness and preparation. If this indeed works, then naming the coming storms in the stock market in 2014 may be a great idea.

Winter Storm Dion shut down airports, schools, and businesses in parts of the United States last week in the midst of the holiday shopping season, but it is unlikely to have had a measureable economic impact or to cause a storm in the markets.

Yes, winter storms have names. For several hundred years names have been assigned to hurricanes and tropical storms; the World Meteorological Organization is in charge of assigning names to those events. But just a year ago, starting with the 2012–13 winter storm season, The Weather Channel announced it would start naming winter storms in an effort to raise awareness and preparation.

If this indeed works, then it may be a great idea to apply to the stock market. Perhaps we should name the stock market declines, or market storms, as they unfold during the year in order to raise investor awareness and preparation. An average year holds four market storms that have a magnitude of greater than a 5% decline with at least one major storm that has a peak-to-trough decline of 15.8% in the S&P 500 over the past 20 years. Even when excluding recession years, the average annual peak-to-trough stock market decline is still over 10%, the magnitude that defines a major storm.

We forecast a 10–15% gain for the S&P 500 in 2014*. However, we expect that gain to be accompanied by a few named market storms next year and could even see a major storm of 10% or more develop. There was little need to name the pullbacks in 2013 since all but one were less than 5%. The biggest of them was a peak-to-trough decline of just 5.8%, the smallest such move in a year since 1995. So, in 2013 there were clearly no major storms in the markets—much like the 2013 Atlantic hurricane season, which was the first since 1994 to end with no major hurricanes. In contrast, we believe 2014 is likely to mark the return of volatility.

The Market Storm Names proposed here for 2014 [Figure 1] also happen to be the top dog names for the year. Given Wall Street vernacular, it may seem like naming pullbacks after famous bears like Gentle Ben, Fozzie, Yogi, Winnie-the-Pooh, or Teddy would make more sense, but, counter-intuitively, this just makes them sound too cuddly. Also, the storms are not bear markets; they are just temporary pullbacks on the way to double-digit gains we are forecasting for the year.

1 List of Market Storm Names for 2014

Angel	_____
Buster	_____
Chloe	_____
Duke	_____
Ginger	_____
Harley	_____
Jack	_____
Lucy	_____
Max	_____
Princess	_____
Rocky	_____
Sadie	_____
Toby	_____

Source: LPL Financial Research 12/16/13



2 Market Storms

		Average Per Year	2013
Market Storm	> 5% PEAK-TO-TROUGH DECLINE IN S&P 500 INDEX	4	1 (5.8%)
Major Market Storm	> 10% PEAK-TO-TROUGH DECLINE IN S&P 500 INDEX	1	0

Source: LPL Financial Research 12/16/13

Past performance is no guarantee of future results.

The *2014 Farmer's Almanac* predicts a major winter storm for February 2014. In our *Outlook 2014* entitled *The Investor's Almanac*, we forecast a rise in stock market volatility in 2014—as some market storms are likely to develop. We expect those storms to be driven by the emergence of occasional “growth scares,” as economic activity may not accelerate in a straight line. Temporarily weak data on jobs or demand—more than actions by policymakers—are likely to drive the market storms in 2014.

When may Market Storm Angel—the first of the 2014 market storms—arrive? Weak economic data readings led to 5% or more pullbacks in the spring of each of the past four years. We may again see some seasonal weakness in the economic data that could fuel a market storm in the early months of the year. However, a spring pullback in the S&P 500 Index is very likely to be from higher than current levels, so there is no need to take action now. Instead it may be helpful simply to prepare mentally for a stormier market in 2014 than we experienced in 2013.

More market storms are not necessarily a bad thing for long-term investors. Greater volatility may provide an opportunity to buy the dips in the market and for active managers to outperform their benchmarks. In fact, the average U.S. large cap active manager has historically outperformed the S&P 500 most of the time during periods of heightened volatility, defined by the VIX being more than 2 points above its 3-year average. That compares to outperforming just 38% of the time when market volatility is lower, as measured by the Morningstar U.S. Large Cap Blend category.

Whether naming a market storm raises awareness in a positive way or prompts beneficial actions is debatable, and this proposal to name market storms is a bit tongue-in-cheek in keeping with the fun spirit of the holiday season. But it is important for individual investors to be aware of and prepare for greater volatility as they allocate to stocks in their portfolios. ■

US Large-Cap Blend Equity category is fairly representative of the overall US equity market in size, growth rates, and price. Equities in the top 70% of the capitalization of the US equity market are defined as large cap. The blend style is assigned to investments where neither growth nor value characteristics predominate. Managers invest at least 75% of their total assets in equities, and invest at least 75% of equity assets in US equities.

The VIX is a measure of the volatility implied in the prices of options contracts for the S&P 500. It is a market-based estimate of future volatility. When sentiment reaches one extreme or the other, the market typically reverses course. While this is not necessarily predictive it does measure the current degree of fear present in the stock market.



IMPORTANT DISCLOSURES

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The economic forecasts set forth in the presentation may not develop as predicted and there can be no guarantee that strategies promoted will be successful.

Stock and mutual fund 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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