Chart of the Month

October 2014

STANDARD & POOR'S 500
Channel Surfing

The stock market, as measured by the Standard & Poor's 500, fell nearly 10% from its peak on September 19 to its trough on October 15. The pundits attributed the largest decline in almost three years to a myriad of issues, including fears about Ebola, ISIS, and a looming recession in Europe. Importantly, the correction had little to do with the fundamentals that drive prices over the longer term. Instead, the latter half of the plunge was a self-fulfilling prophecy as selling beget more selling due to breakdowns in certain "support" levels coupled with margin calls that forced hedge funds and many speculators to unwind their leveraged positions.

Over the past week, the market has rebounded 7% and is now within about 3% of its previous high. The V-shaped drop and subsequent rise has confounded the naysayers once again. Investors need to be aware that the S&P 500 has averaged *three* 5% or greater dips every year since 1928. In other words, stock prices regularly ebb and flow and the volatility just comes with the territory.

As shown in the graph above, the S&P 500 has been trading within an upward-sloping channel since 2011. The trend lines, which run parallel to one another, have captured the interim highs and lows over the past three years. While this graph is not meant to predict the future direction of stock prices, it is interesting to note that the recent tumble failed to pierce the low-end of the channel. We see no reason for now to deviate from the adage that the "trend is your friend."

History may also be on the side of those who are long stocks. In the 11 prior periods in which the S&P hit a 12-month high in September and then receded 5% at some point in October as it did this year, the index experienced a positive November eight times with an average gain of 1.3% or 2.8% ex-1929 (see table below). Furthermore, the market advanced at least 3% through December in each year other than the beginning of the Great Depression, with an average increase of 3.8% or 5.3% ex-1929. The fourth quarter of the second year of the Presidential Cycle has also produced the highest return of the 16 quarters in a full term since 1950.

The combination of seasonal factors and solid fundamentals (including a growing economy, rising corporate profits and dividends, and low interest rates and inflation) should give investors the confidence to withstand the day-to-day or week-to-week gyrations in stock prices.

S&P 500 PERFORMANCE

YEAR	NOV	NOV + DEC	YEAR	NOV	NOV + DEC
1929	-13.4%	-11.2%	1979	4.3%	6.0%
1935	3.9%	7.8%	1980	10.2%	6.5%
1955	7.5%	7.4%	1989	1.7%	3.8%
1967	0.8%	3.4%	1991	-4.4%	6.3%
1976	-0.8%	4.4%	1992	3.0%	4.1%
1978	1.7%	3.2%	2014	?	?

Source: SentimenTrader

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