CHART OF THE MONTH

JANUARY 2019

Following a three-month period in which the major market indexes fell approximately 20% from their high in September to their low on Christmas Eve, there are a couple of indicators that suggest stock prices might be in the midst of bottoming and, in fact, may have hit a trough last week.

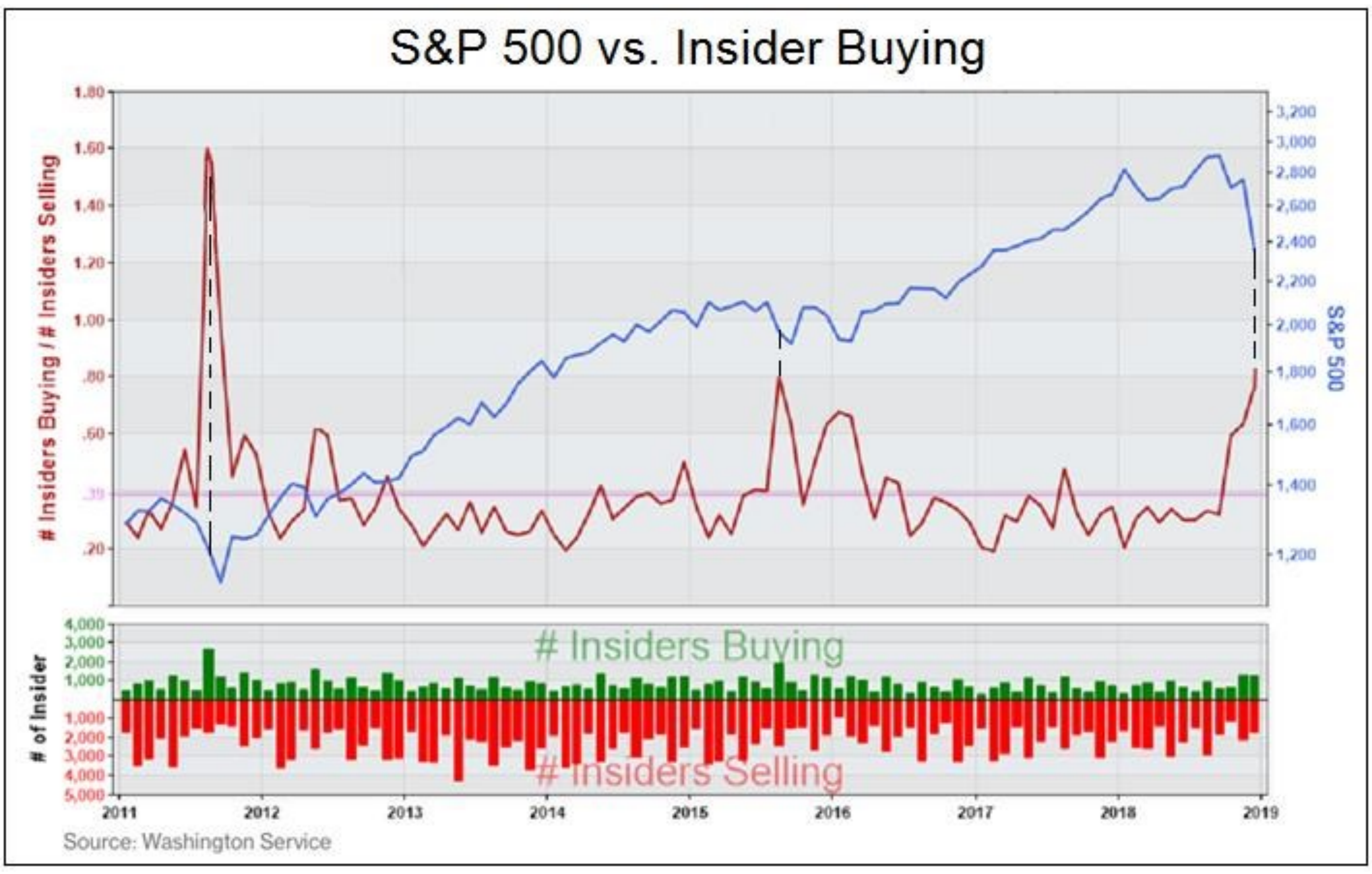
While the Dow Jones Industrial Average posted its worst Christmas Eve ever, the Dow soared more than 1,000 points for the first time in a single session on the day after Christmas, its biggest one-day percentage gain since March 2009. The blue-chip index then fell over 600 points at its low on Thursday, yet ended the session up 260 for a record swing of 871 points. As of Monday, the DJIA had gained or lost at least 250 points in nine of the previous eleven trading days with the first six negative and the last three positive.

Although dizzying (and even nonsensical in our opinion), the extreme volatility may be indicative of a market bottom. As shown in the S&P 500 vs. Fear Index, such spikes in the VIX Index/10-Year Treasury Yield (red line) have historically correlated with lows in the stock market. The VIX, which is a widely followed index that measures volatility, closed at 36.07 last Monday. The yield on the 10-year Treasury was 2.75% that same day. The Fear Index, computed as the ratio of these two components, was 13.1, a level that has been reached about once or twice each year since 2015. In each case, the S&P 500 made a meaningful low and rebounded decisively in the period ahead.

Like the Fear Index, surges in insider buying have corresponded well with market bottoms (as displayed in the chart below). The number of corporate executives purchasing shares of their own companies has doubled in the past two months from the prior two. As a result, the ratio of insider buying to selling is at its highest level since August 2011 when the market was within weeks of a multi-year rally.

Meanwhile, due to an increase of more than 20% in corporate earnings (the highest annual growth since 2010) and a decline of approximately 5% in the major indexes in 2018, the S&P 500's current price-to-earnings ratio (14.2) is not only significantly lower today than a year ago but below the five-year (16.4) and ten-year (14.6) averages. In addition, the earnings yield (defined as the inverse of the P/E ratio) of 7.0% compares favorably to bond yields and the capitalization rates on real estate.

Sure, the news of the day (be it the Fed, China trade talks, slowing global growth, and the government shutdown) may give some market participants reasons to pause (and others to panic), long-term investors recognize that the price of a stock is only important on the day you have to sell it. In the words of Warren Buffett, "be fearful when others are greedy and greedy when others are fearful."



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