Weekly Market Commentary

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The Comeback

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Highlights

The similarities between 1967 and 2013 suggest that if the pattern in the stock market continues to hold, as we believe it may, and lawmakers eventually "kick the can" on the fiscal issues, the concerns that have led to the current pullback may give way to a resolution that powers a comeback later this year, as we saw in 1967.

Down 8-to-1, Oracle Team USA won the last eight races in a row in an epic comeback to win the 34th America's Cup last week. Almost as unexpected, the yield on the 10-year U.S. Treasury note has fallen almost eight days in a row, helping to bring the rally in yields from 3% to 2.6%.

The comeback for the U.S. bond market is due to the Federal Reserve's (Fed) decision that economic data have not been strong enough to begin slowing the pace of its bond-buying program, in addition to generally disappointing economic data since the Fed's meeting on September 18. This week provides the widely watched Institute for Supply Management (ISM) report on manufacturing on Tuesday, October 1, 2013 and the employment report (if the government agency's staff is working) on Friday, October 4, 2013. Strong readings may lift stocks and bond yields, while readings on the weak side could exacerbate pressure on markets. In general, the economic numbers are expected to be similar to those of recent months.

In addition, last week's (September 23–27, 2013) declines in both stocks and bond yields reveal market participants are worried about the economic impact of a government shutdown and breaching the debt ceiling. The stock market decline of about 2% from the recent peak set on September 18 has been modest, perhaps because the average S&P 500 decline during government shutdowns—which have taken place 16 times over the past 37 years, including seven times in the 1980s, and lasted anywhere from one to 21 days—is only about 2%. A shutdown of even up to a few weeks should not have sharp negative consequences for the stock market.

However, the bigger issue is a breach of the debt ceiling on October 17, given the remote but heightened threat of default on some U.S. obligations if lawmakers fail to increase the limit on total U.S. federal government debt. Fear over the threat posed by the debt ceiling seems well contained at this point. For example, the VIX, often called the "fear gauge," is currently around 16 and not the 48 seen in August of 2011, when the debt ceiling was last the subject of a battle in Washington and stocks fell 17%. Also, default concerns currently seem minimal with the discount on the one-month T-bill at a mere 2 basis points versus 17 basis points at the peak of fear in early August 2011.

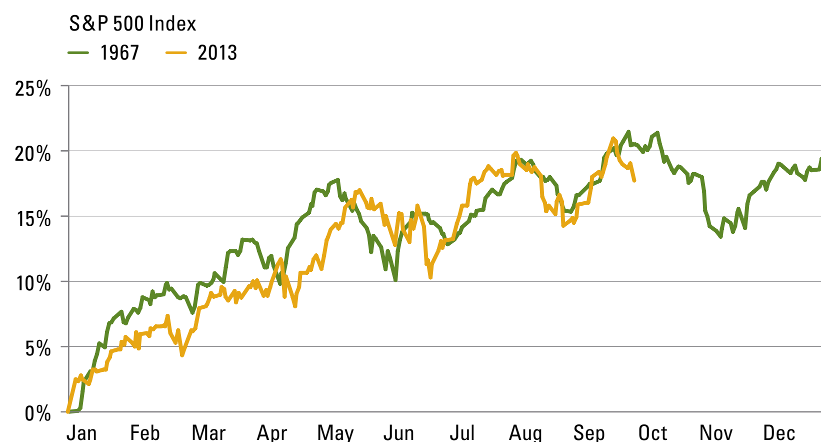
The VIX is a measure of the volatility implied in the prices of options contracts for the S&P 500. It is a market-based estimate of future volatility. When sentiment reaches one extreme or the other, the market typically reverses course. While this is not necessarily predictive it does measure the current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

As we wrote last week, the stock market pullback is part of the "kick-the-can" pattern we have seen numerous times this year ahead of a resolution

to “kick the can” on various issues to a future date. This is driving market volatility and a pattern of performance this year that echoes 1967, a year when:

- Republican lawmakers voted down a debt ceiling increase (before they later passed it);
- Syria was involved in a war;
- Bond yields rose (most notably from April to August when the 10-year Treasury note rose about one percentage point);
- Gross domestic product (GDP) averaged a lackluster 2% in the first half of the year;
- Earnings per share growth for S&P 500 companies was roughly flat on a year-over-year basis; and
- The United States won the America’s Cup with a sweep.

1 Stocks Continue to Track 1967’s Pattern



Source: Bloomberg, LPL Financial Research 09/27/13

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The S&P 500 Index is is an unmanaged index, which cannot be invested into directly. The returns do not reflect fees, sales charges or expenses. Index performance is not indicative of any particular investment.

The similarities between 1967 and 2013 suggest that if the pattern continues to hold, as we believe it may, lawmakers will eventually “kick the can” on the fiscal issues, and the concerns leading to the current pullback may give way to a resolution that powers a comeback for U.S. stocks later this year, as we saw in 1967. ■

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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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