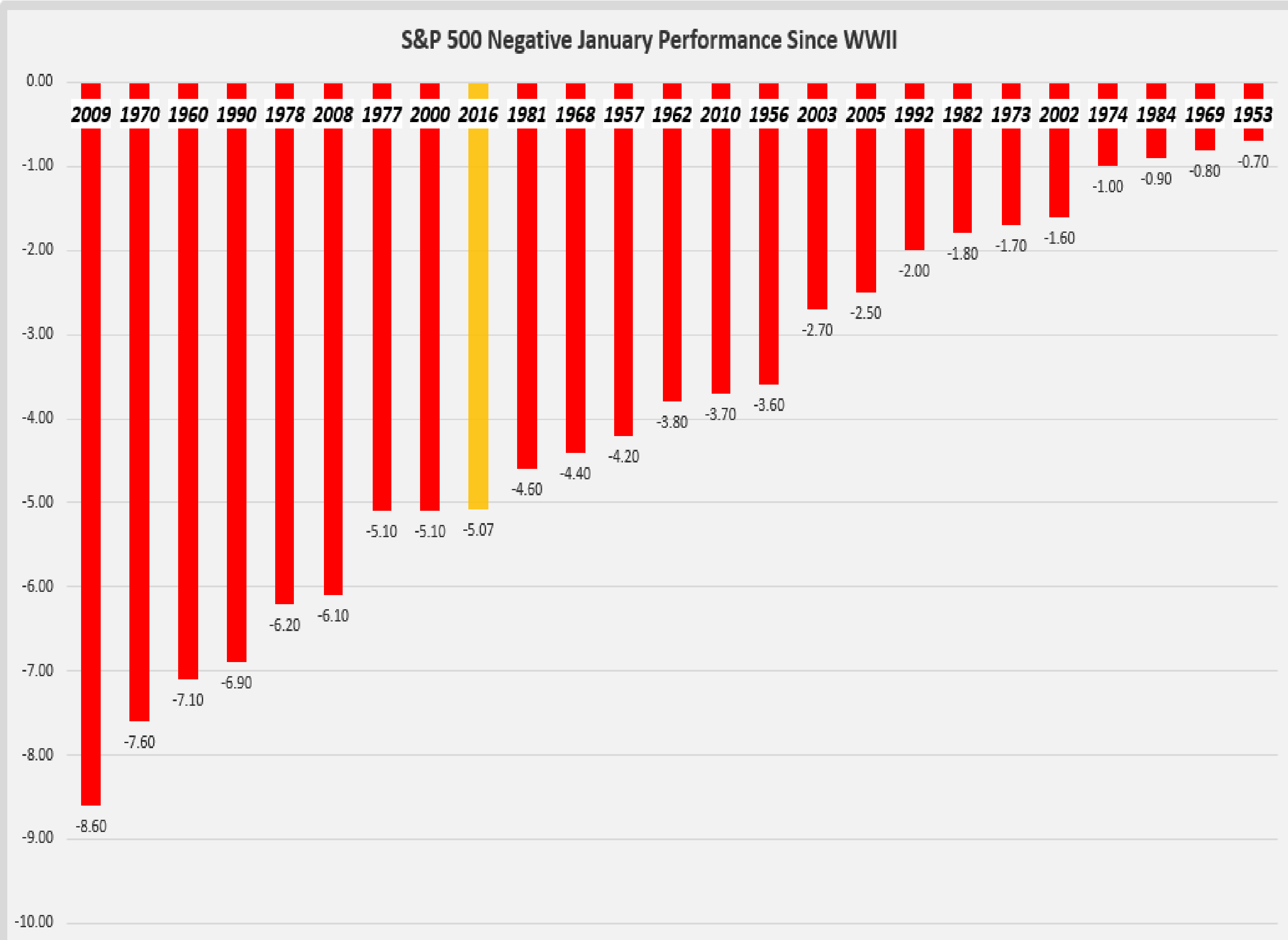
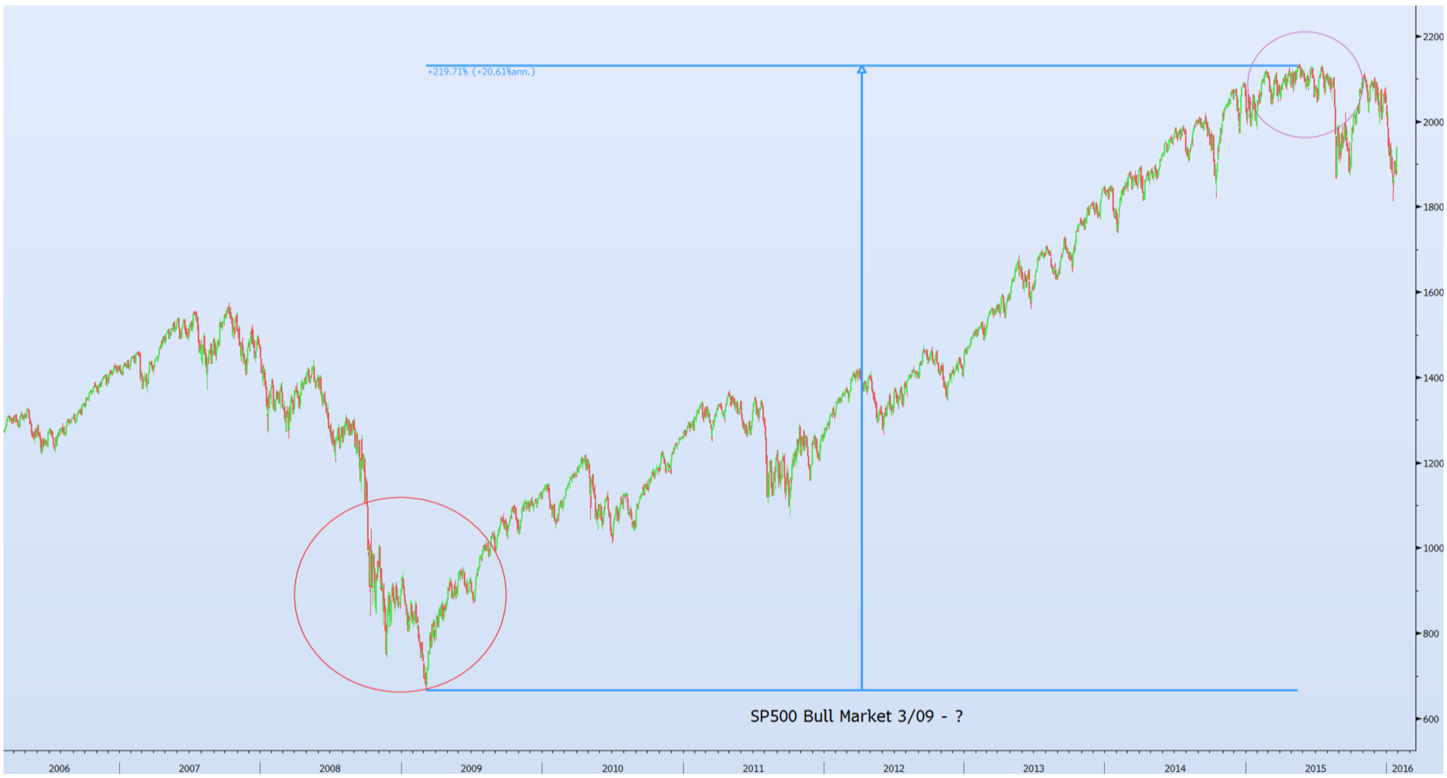
As January Goes, So Goes the Year



The month of January was just plain rotten for stocks. Large -Caps, Mid-Caps and Small-Caps all took it on the chin. The S&P 500 posted one of the worst January performances since WWII, down 5.07%, which isn't far from its January 2008 financial crises number of -6.12%. January's selloff has left investors at a cross-roads of sorts. Are things really about to turn south from here? Is it time to jump ship before markets really tumble? Will the faltering growth of the economy come to a halt, in turn sending us into a recession? Will the FED try new measures to keep the economy on track? Or, is it possible our elected officials in Washington could take initiative and enact needed pro-growth policies that would put the recovery on a more solid footing? These are a few of the questions looming from the January 2016 stock market selloff.

The S&P 500 began this "Bull Market" on the close of March 9, 2009. As the chart below depicts, it rose 219% from trough to peak. Including intraday gyrations, the S&P 500 actually fell to 666.79 on March 3rd. The rally since those dark days has been impressive. Stocks rose for 6 years, 2 months and 14 days until May 20, 2015, which at this point appears a top.

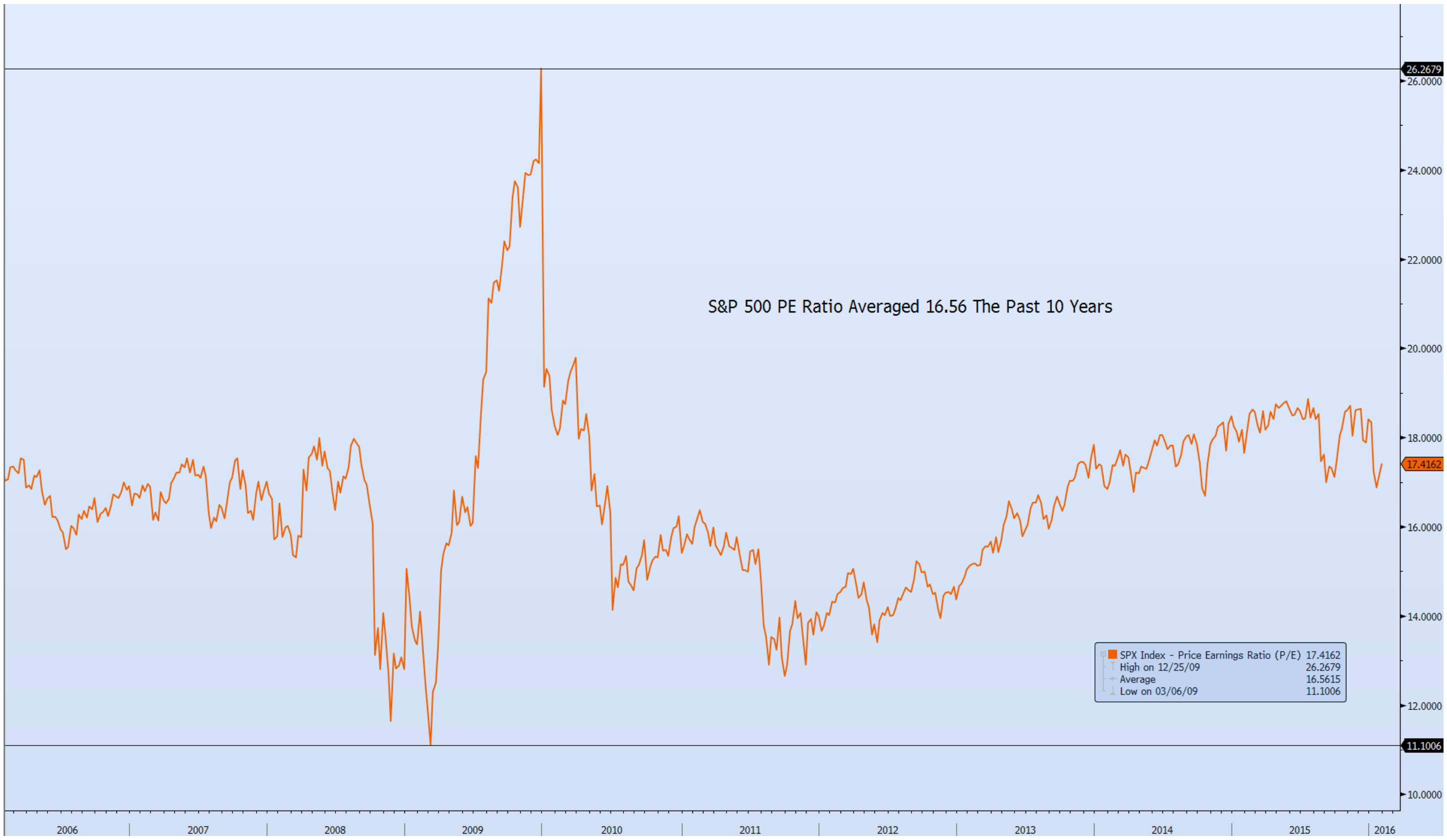


What was the investment climate before this Bull Market began? I can tell you this, it wasn't pretty. The euphoria of the internet era (late '90s) was short lived and is now better known as the "dot-com bust" of 2000. The chart below shows that by owning the S&P 500 going back to March 2000 until today, the price rose 29.5% over the course of 16 years. That equates to a 1.64% annualized return in price appreciation, which is quite meager considering the volatility that accompanied it. When you look at the magnitude of the bear markets of 2000 and 2007 with S&P 500 declines of 49.1% and 56.8% respectively, one thing is for sure, it hasn’t been fun.

If the NASDAQ Composite was your area of investment during this period - which was the rave at the time - your return is practically zilch. The misery was wretched.

It's apparent that the past decade and a half has been quite painful for enterprising investors. They say that every cloud has a silver lining. When it comes to the S&P 500, the silver lining has been its dividends. Dividends fluctuated around 2% during this period for shareholders of the S&P 500, rewarding long term investors with a total annualized return of around 4%. However, if you were less fortunate and instead owned the NASDAQ Composite (which paid a pittance in dividends during the tech mania), the return has been abysmal and certainly wasn't worth the aggravation. If 2016 ends up being a dour year for investors, history reminds us that it will not last forever. When the market falls into correction mode (minus 10% to 20% range), opportunities surface and dividend yields are higher. When stock prices fall, dividend yields go up. From my view, it looks like a number of high quality dividend paying stocks are becoming attractive. For example, if an investor purchased the FTSE High Dividend Yield Index and held it for the past 13 years, the price increase was 3.9% and with a dividend around 3% this made for a decent return. During this period interest rates were on the decline, which lifted yield bearing securities. So, how will a less accommodative FED impact yield oriented selections? If the FED continues to moderately raise rates, it will be a proxy that the economy is improving. Companies in the marketplace benefit from sustained economic growth. These benefits are shared by shareholders as increased earnings, share buy-backs and dividend increases.

Is the market overvalued? The chart below shows the Price-to-Earnings (PE) multiple of the S&P 500 over the past 10 years. This period encompasses the "Great Recession" that dealt America its deepest contraction since the 1930s. PE multiples bounced from as low as 11 to as high as 26, the average being 16.5. Today's PE is 17.4. Does this imply that we have another 5% downside as the market regresses to the mean? The fact that the U.S. employment rate is now 5.0% and there are 7.7 million more people working today compared to the average during this time frame leads me to think that stocks are not unreasonably expensive.



Wall Street is known to be the place where whenever the merchandise goes on sale, the shoppers run away. In the weeks ahead I suspect there will a number of deals that transpire on Wall Street by the most astute big game hunters seeking opportunities. If the market continues to mark down prices, 2016 is looking to be a year set to reward bargain shoppers.