Weekly Market Commentary

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The Spring Slide

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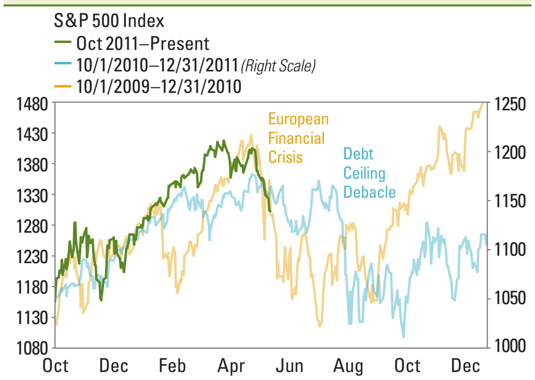
Highlights

Now that the Spring Slide is in full swing, we have to watch out for the big event with the potential to make it as severe as the past two years.

Looking ahead, the negatives we face in 2012 already include the end of the Federal Reserve's (Fed) Operation Twist stimulus program, China's slowdown, the European recession, geopolitical risks, the election uncertainty, and anticipation of the 2013 budget bombshell of tax hikes and spending cuts.

However, some positives this year may help offset some of the negatives, making for a potential decline that may be less steep than those of the past two years.

1 Three Spring Slides



Source: LPL Financial, Bloomberg Data 05/21/12

The S&P 500 is an unmanaged index, which cannot be invested into directly. Past performance is no guarantee of future results.

It has been 410 years since the first initial public offering (IPO). The Dutch East India Company helped people add spice to their daily lives, connect to those in faraway places, and became the richest company the world had ever seen. High hopes for similar success surrounded the Facebook IPO on Friday. However, the long-awaited IPO was unable to spur enthusiasm among stock market investors. Stocks posted the worst week in six months as the S&P 500 fell 4.3%, making three straight weeks of declines culminating in an 8.7% decline from this year's peak in April.

In each of the past two years, the stock market began a slide in the spring, a phenomenon often referred to by the old adage "sell in May and go away," which lasted well into the summer months. In both 2010 and 2011, an early run-up in the stock market, similar to this year, pushed stocks up about 10% for the year by mid-April. On April 23, 2010 and April 29, 2011, the S&P 500 made peaks that were followed by 16–19% losses that were not recouped for more than five months. On March 26, we published the 10 indicators that warned of another Spring Slide this year but noted that this year's decline may not be as steep as in the prior years. Now that the Spring Slide is in full swing, we have to watch out for the big event with the potential to make it as severe as the past two years.

A combination of factors contributed to the reversal in direction for the stock market, including an extended and exhausted rally, a slowdown in the economy, and weakening earnings outlooks. But what added fuel to the decline in 2010 was the negative environment that included the end of the Fed's QE1 stimulus program, the uncertainty around the impact of the Dodd-Frank legislation, the passage of the Affordable Care Act, the Eurozone debt problems and bailouts, central bank rate hikes, and the end of the homebuyer tax credit. In 2011, the negatives that helped drive the slide further included the end of the Fed's QE2 stimulus program, the Japan earthquake and nuclear disaster that disrupted global supply chains and pulled Japan into a recession, the Arab Spring erupted pushing up oil prices, rising inflation, central bank rate hikes, the Eurozone debt problems coming to a head, and, most importantly, the budget debacle and related downgrade of U.S. Treasuries.

Looking ahead, the negatives we face in 2012 already include the end of the Fed's Operation Twist stimulus program, China's slowdown, the European recession, geopolitical risks, the election uncertainty, and anticipation of the 2013 budget bombshell of tax hikes and spending cuts. However, some positives this year may help offset some of the negatives, making for a potential decline that may be less steep than those of the past two years.

- First, central banks are now cutting rather than hiking rates, which should help to temper global recession fears evident during the past two years' Spring Slides. For example, China has cut reserve requirements three times in the past six months.
- Second, housing is showing signs of improvement, as both new and existing home sales are rising at a 5–7% pace, and home prices are now on the rise.
- Third, gasoline and food prices are decelerating, which helps to explain why consumer sentiment has been rising along with retail sales in May despite the market decline.
- Finally, auto production schedules are robust for the next quarter and likely to support manufacturing activity, which had fallen in May through July of the past two years and contributed to the market decline.

We will be on the lookout for signs that the Spring Slide may be as steep as the past couple of years. However, we will also be preparing our shopping list to take advantage of this broad pullback in the markets as it runs its course. ■

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