HAWK 100

HAWK Talon

Monthly Insights from Hawk100 Issue 34, October 2011

Greece Is Slippery.

Even with a strong month for US stocks, European stocks performed better. The MSCI EMU Index, representing large stocks from across the European Union, was up 12.9% during the month. MSCI tracks a country index for eight of the seventeen countries on the euro currency. Five of those eight gained over 12% in October. Italy astonishingly rose 13.5%.

Italy is in financial straights. As proof, Siena- based Banca Monte dei Paschi di Siena SpA is on the brink of failure. The world's oldest bank was founded twenty years before Columbus's famous voyage. Owning too much Italian sovereign debt seems to be the chief cause of its trouble. Italy's trouble is its adoration of Greece.

Efforts to save Greece have been slippery. Having completed the fifth review mission to Greece, the IMF, EC, and ECB called its recession deeper than anticipated and fiscal targets "no longer within reach."

In search of a solution, the EU upped ante on its Greece gamble. Announcing another package hammered at an EU summit, EU President José Manuel Barroso said, "Europe will do what it takes to safeguard financial stability."

Evidently, "it takes" ignorance (read EU summit statement, "the euro continues to rest on solid fundamentals."), deep private sector concessions on sovereign debts, and borrowing from the Chinese. It looks a lot like TARP did in the US.

Your wealth.
Your life.
Aligned.

6600 Perimeter Dr.
Suite 200
Dublin, Ohio 43016

614.791.HAWK

www.hawk100.com

Stocks Bounce Back.


S&P 500 Index daily prices. SOURCE: Standard and Poors, Fidelity Investments.

I recently mused that that investors may be tempted to trade "blocks of stocks for a box of rocks." Before October, stocks dropped in five consecutive months and just suffered the worst quarterly loss, -13.9%, since 2008.

Then October 4, Federal Reserve Chair Bernanke delivered glum comments to Congress's Joint Economic Committee. "...pattern of sluggish growth…cautious in their spending...financial stresses persist...hurt household and business...ongoing risks." Bernanke's dire speech admitted the Fed "is not a panacea" to fix America's problems and served Congress with sobering responsibility to get on board with the private sector.

Stocks swooned. By midday October 4, just the month's second trading session, the S&P 500 had already lost over 5% from September 30. Then, Bernanke made his closing remark. "For our part, we at the Federal Reserve will continue to work to help create an environment that provides the greatest possible economic opportunity for all Americans."

That remark reassured despondent investors wanting a positive interpretation. Dow Jones led its report on the speech, saying, "the central bank is ready to do more to boost the economy." Dow Jones quoted Steve Sosnick, of Timber Hill/Interactive Brokers Group, "...the mood can change on a dime in this environment..."

That was an understatement. The mood definitely and rapidly changed. Stocks raced ahead at a rare and blistering pace. From the intraday low October 4 to the intraday high October 27, the S&P 500 rose 20.3%. Absent a 2.5% drop on the last trading day, October returns would have ranked among the top-ten all-time months and the best since 1974. As it was for the month, the index returned 10.9% to mark the biggest single monthly gain since December 1991.

To further analyze October from an historical context, I measured monthly S&P 500 returns dating to 1924. October was the twenty-eighth month that returns met or exceeded 10% (fourteen just in the 1930s). We'll call these "super months" for their remarkably positive returns. The average return for past super months was 15.5%. Returns for the full years following each super month have averaged 7.4%—barely above the 7.0% historical average annual return for all years since 1924. Annual returns following the super months vary widely (deviation 31.8% and range from –71.5% to +67.3%). Subsequent annual returns have been positive with 88% confidence though not significantly different from average periods. Those past trends would support a normal allocation to equities for the coming year.

I believe October's extraordinary return can be explained partly by poor stock performance in the preceding months which afforded discounted prices. If so, returns could be more positive than just suggested.

Again, I examined the super months to investigate this claim. Since 1924, average quarterly stock returns are 2.2%. The super months on average were preceded by quarterly losses of –0.3%. Excluding the eleven instances when stocks actually gained during the preceding quarter (leaving only those super months preceded by losses as was the case this October), the average loss moves to –11.8%—barely above the –13.9% that preceded this October. The sample of sixteen super months appears to closely represent the conditions of this October. Annual returns following the sample super months were just 4.2% and the deviation of returns is even wider than before.

The relatively lackluster result of this test suggests that it may be a lackluster year ahead for equities.

By Richard Clemens, CFA, *President*