MARKET PULSE REPORT

FEBRUARY 2017

PATHSTONE FEDERAL STREET

SUMMARY

If it holds true, the old market adage "As January goes, so goes the year" would suggest good things are in store for equity markets in 2017.

We do have a generally optimistic outlook for the next 12 months, though for different reasons—our view is based on an analysis of improving market fundamentals.

ARE JANUARY'S GAINS A GOOD OMEN?

According to a well-recited traders' omen, "As January goes, so goes the year." The so-called January Barometer, as first mentioned by Yale Hirsch of the Stock Trader's Almanac, suggests the performance of stocks in the first month of the calendar year dictates where prices will head for the year overall. With the S&P 500 scraping out a 1.8% gain to kick off 2017 (the index's first January gain since 2013), followers of this fortune-telling phenomenon are likely cheering the prospects of a prosperous year ahead. But do simple rules of thumb such as this, which are particularly alluring to fall back on during political and policy uncertainty, really work?

Most of the time, it works every time. Since 1926, 73% of time, the remaining calendar year moved in the same direction as January, a record that would be the envy of many market prognosticators. This is more true for the years when January did well (a positive January matched by a positive year), with an 85% success rate. In fact, since 1950, only two years finished with a loss after a positive January (1966 and 2001). It's not perfect, but it sure seems to be consistent most of the time, and that could portend a positive outlook for 2017.

Unfortunately there are few clear intuitive reasons for why this augury plays out. Perhaps it is simply that stocks tend to rise during any 12-

month period—over the past century about 62% of all calendar years were positive. By coincidence, January tends to be a generally bullish month for stocks, perhaps as investors put Christmas bonuses to work. Momentum may also be part of the story, as bandwagon investors jump on any rising trend that January experiences.

Regardless, while there is not clear evidence as to why there is such a high correlation between a positive January and a positive full calendar year, many investors take solace in historical rules of thumb. It may actually become self-reinforcing, with a boost in confidence and sentiment driving further gains.

What about the downside? While not applicable this year, it appears the formula does not work nearly so well if January is negative. Of the 35 times a losing January has been experienced since 1926, the remainder of the year has still generated a positive return 20 times (or 57%). Lest you forget, we have had a negative January in each of the prior three years (2014-2016) and the S&P 500 has ended moving upward every time. Ouch, so much for the predictive power of this indicator helping to avoid prolonged downturns in the market.

Fundamentals have us cautiously optimistic. Rather than rely on coincidental statistics, our investment approach is based on our views of economic and market fundamentals and valuations. In that regard, we do believe that there is continued support for stocks. January's gains were driven in part by hopes for renewed economic and earnings growth as potentially stimulative fiscal policies start to take shape. Despite a subpar reading for last quarter's gross domestic product, many data points (such as housing and manufacturing activity) are trending up.

Sure, the end of the month saw some profits eroded on worries about restrictive immigration policies, but the economy appears to be in solid shape and, over time, that bodes well for equity markets. And while U.S. markets are getting a bit expensive, there may yet be some upside, especially for comparatively more affordable international equity markets.

January was a decent start—we'll take it. However, our outlook for the rest of the year will be influenced by our ongoing observations of the data, not omens or fortune-telling affirmations.

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