Weekly Market Commentary

February 3, 2014

Turn Down the Volume

Jeffrey Kleintop, CFA
Chief Market Strategist
LPL Financial

Highlights

It is not unusual to see the market dip 3% in a month; what was unusual about January's stock market trading was the volume surging to levels not seen since May 2010. Such spikes have historically coincided with losses, but they were not sustained for long.

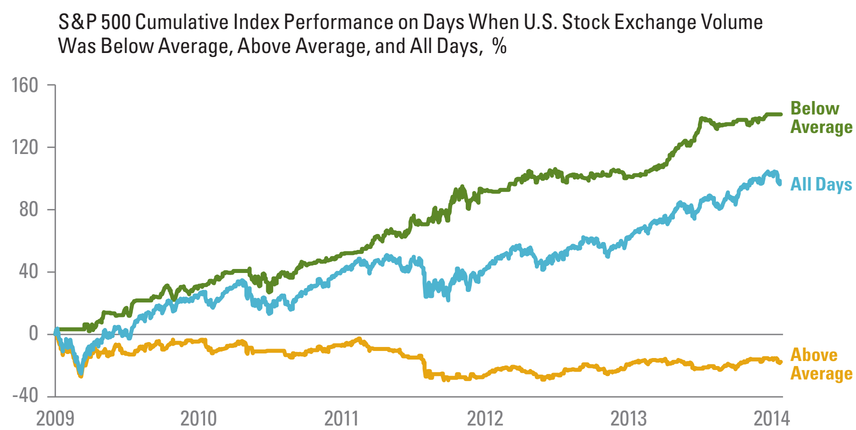
January saw a loss of 3.5%, the biggest one-month loss in the S&P 500 Index since May 2012. The main driver of the market weakness seems to be sharp currency declines and accompanying stock market losses in several emerging markets, such as South Africa and Turkey (for reasons we previewed in the September 16, 2013 *Weekly Market Commentary: Emerging Markets and the Fed—What's Attractive and What to Avoid*).

It is not unusual to see the market dip 3% in a month, especially after such a strong run-up throughout 2013. We have seen 18 months of losses for the S&P 500 since the bull market began 59 months ago in March 2009—that is about one-third of the months. The average decline during those months was 3.1%. So January's 3% stock market dip is not particularly unusual or alarming.

What was unusual about January's stock market trading was the volume. Importantly, the stock market and trading volume have not been on friendly terms in recent years. In fact, over the past five years' low-volume days (when stock trading volume is below its 50-day moving average) stocks have generally gone up, as you can see in Figure 1. Conversely, when volume is above average, stocks have generally been flat to down.

The stock market and trading volume have not been on friendly terms in recent years.

1 Turn Down the Volume!



Source: LPL Financial Research, Bloomberg data 02/03/14

Past performance is no guarantee of future results.

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

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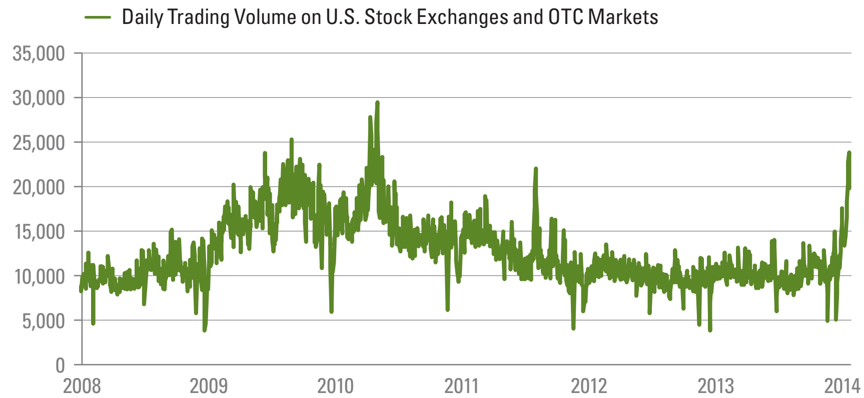
The doubling of trading volume in January from the average of prior months coincided with losses for stocks.

2 Trading Surged in January



Source: LPL Financial Research, Bloomberg data 02/03/14

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In January, daily trading volume rose on the U.S. stock exchanges, and when combined with trading off the exchanges (referred to as the over-the-counter market), total trading volume surged to levels not seen since May 2010 [Figure 2]. With the stock market tending to decline when volume is above average, it is no wonder that the doubling of trading volume in January from the average of prior months coincided with losses for stocks.

When it comes to volume, be careful what you wish for. A common criticism of the bull market in recent years is that buyers do not have a lot of conviction because volume has not been strong. The implication has been if volume does not pick up, the market may decline. However, the past few years show the opposite: that markets climb on relatively quiet trading for long stretches of time and then briefly pull back as volume jumps.

What caused such a surge in trading in January? It is hard to say exactly — weather-impacted economic data points, emerging market turmoil, or the Federal Reserve (Fed) tapering its bond purchases. But given recent history, the good news is that the spikes in trading volume have not been sustained for long, and, as the volume turns back down, markets have historically recouped losses.

Market participants are taking a cautious view on some of the softer readings on the economy. While getting a good read on economic growth is difficult through the weather-related distortions of December and January, the pace of growth had been improving in the second half of 2013 and is likely to have sustained that pace in the last couple of months. We expect the data to firm back up as the weather-related distortions fade.

The weakness in emerging markets should not be seen as a signal of a broad global economic deterioration that could spread and tip the world back into a global recession. In fact, just the opposite — many emerging markets had become dependent upon global economic weakness. The soft global economy of the past five years prompted the Federal Reserve (Fed) and other central banks to pump money into the global financial system, encouraging capital to flow into the emerging markets and allowing them to run unsustainable current account and budget deficits. Now, as global growth is improving, we are seeing the Fed begin to slow its bond purchases, and that change is prompting some emerging markets to have to quickly adjust by devaluing their currencies and sharply slowing spending. So, much of the turmoil in the emerging markets is actually the result of the improving economic growth around the world and not a sign that it is weakening. Therefore, we do not see the January dip as the start of a bear market and global recession. ■

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.

RES 4494 0214
Tracking #1-242607 (Exp. 02/15)