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Worst Start EVER to a New Year

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It's been a very rough start to 2016 for the global stock markets and I don't think it's over just yet. Markets typically don't bottom on Fridays. September 21, 2001 comes to mind as one and April 11, 1997 as another, but they are few and very far between. This bout of weakness should spill over at least into next week before even a trading low is seen. From there, we will see when and how the market tries to hammer in a low and the quality of the rally that ensues.

Blame has been laid on China's stock market collapse as well as the tensions between Saudi Arabia and Iran. While they may have played a part or exacerbated the weakness, this decline has roots from the peak in October and inability for stocks to mount any kind of significant and healthy rally since.

What we are seeing is a market event rather than an economic or systemic event. Think of it as a re-pricing of risk. For the past few years, I have warned that the biggest consequence of a Fed interest rate hike wasn't going to be a hindrance to the economy or stock market, but rather a surge in market volatility. Remember, volatility cuts both ways although we often only associate it with declines.
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Since the Fed hiked rates three weeks ago, daily volatility has certainly increased. While it may be uncomfortable, it's the new reality we are going to live with for some time.

The first four days of 2016 now rank as the number one worst start to any calendar year at -4.93% for the S&P 500. Thanks to some nice work by Ryan Detrick (@ryandetrick on Twitter and ryandetrick.tumblr.com), you can see below that the rest of January saw a 50% chance of moving higher with an average gain of 2.36% and median gain of 0.34%. The rest of the year showed the same 50-50 odds with an average gain of 2.50% but median loss of 1.13%. The study used the top 15 worst four days starts of the year.

Beware of Believing in Santa Claus

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The traditional Santa Claus rally of the last five trading days of the year did not materialize. As I have mentioned before, Yale Hirsch of Stock Traders Almanac fame made popular the rhyme, "If Santa Claus should fail to call, bears may come to Broad and Wall", meaning that bear markets typically follow in the ensuing years where there is no Santa Claus rally. While it all sounds nice and neat, the data do not support that conclusion.

In 2014, the last five days were down, but 2015, while difficult, was not a bear market year. 2012 saw Santa fail to call, but 2013 was a huge year for stocks. 2010 saw a mixed last five days which led to a flat 2011 although there was a 20% correction during the year. 2009 saw another mixed last five days, but 2010 was a strong year for stocks.

2007 was strongly down during the final five days and that correctly led to the worst year for stocks since the 1930s. 2005 also was a victory for the bears, but 2006 was a banner year for the bulls. 2002 saw a horrible close to the year, but 2003 launched a new bull market a enormous year for the stock market.

On the flip side, 2000, 2001 and 2002 were all bear market years, but the previous Santa Claus indicator failed to warn. As with many other stock market adages, what once worked and became tried and true no longer stands up to scrutiny.

I have a different method for the Santa Claus rally and I have been using this in my portfolios since the early 1990s. There are a set of rules that help identify a December low that is usually plus or minus a number of days around options expiration. From that low there has been a 90% probability of a rally into year-end over the past 25 years. The average percent gains have been staggering.

S&P 500 +2.83%

NASDAQ 100 +4.24%

Russell 2000 +4.13%

S&P 400 +4.24%

2015's results were below average, but still between 1.33% and 1.91%.

Of note, 2015 was the first year in AT LEAST 26 years where the S&P 500 was the leading index from my December Santa Claus low to year-end. I am not sure what it means, but it's something to watch this week.
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Water Needs to Find Its Own Level in China

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Last summer I included China's stock market in a few pieces as it cratered lower and lower. Remember, as I explained, while China may be the second largest economy on earth, they are relatively new to the capitalist system. They have, are and will continue to experience "growing pains" as the powers that be seem to believe they know better when it comes to controls in their financial markets.

Over the summer as their market collapsed, the government instituted all kinds of manipulations to prevent further carnage. They tried injecting their own capital into stocks. They halted trading on hundreds of stocks. They eliminated short selling on others. They put circuit breakers in place to close the stock market totally if it fell by 7%.

At that time, I opined that all they were doing was prolonging the inevitable. Water finds its own level. You can't prevent a selling stampede that's all lined up. And just as their officials were gearing up for the victory lap, sellers began to overwhelm the Shanghai index in late 2015 which has now spilled over to 2016. Instead of stemming the tide, the 7% circuit breaker has led to pile on selling as investors try to get out as soon as the market opens to avoid getting shut out of selling when it falls 7%.

The first solution is to remove the 7% breaker which was executed today and let everyone sell. Rip off the Band-Aid. Be done with it. This may ultimately cause a mini-crash, but my sense is that a good buying opportunity will be closer at hand. The August lows are just under 2900 on the Shanghai index and I would be very surprised if they are not breached this month, maybe next week, in some type of waterfall, capitulatory decline.

Without any anecdotal data to back this up, I have operated under the premise that whenever a major stock market is down 50%, it's time to start buying. Sock some away for retirement. Maybe some for the kids' college. The Shanghai is close to that level again.

2008 Redux This Is Not

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2016 isn't even a full week old (certainly a horrible four days), yet all I am reading and hearing is that it's going to be a terrible year for stocks and similar to 2008. 2007 - 2009 was a generational bear market, the likes of which have only been seen during the Great Depression. These types of strong deflationary spirals take decades of mistakes to create and leave investors scarred even longer. In the western world, we have never, ever seen a repeat within 10, 20 or even 30 years.

Heading into 2008, the housing crisis was already in full bloom. Leverage at the banks and on Wall Street was at epic levels. Corporations had very little cash on hand to buffer any weakness. Today, the massive leverage has also been purged from the system. Banks are sitting on more than $2 trillion in cash and corporations have another $1.5 trillion. Housing is stable and lenders are tight with their money. The economy may not be hitting on all cylinders, but it's far from teetering on collapse. There are no Lehmans, Bear Stearns, Fannies, Freddies, AIGs and the like hanging on by a thread.

To compare 2016 to 2008 is either grandstanding or just plain ignorant.

Upcoming Appearances

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CNBC's Worldwide Exchange - January 13th 5:30 AM

You can view most of the past segments by clicking below.

Media Appearances

(http://www.investfortomorrow.com/InMedia.asp)

Investment Quotes/Adages To Live By

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"The only easy day was yesterday."

- The U.S. Marines

"When in doubt, get out!"

"If it's obvious, it's obviously wrong."
-Joe Granville

"It's ok to be wrong, but it's not ok to stay wrong."

"This time is different."

"The markets require the patience of a dozen men."
-Robert Rhea

"Luck is the residue of effort."

"The most bullish thing a market can do is go up in the face of bad news."

"The most bearish thing a market can do is go down in the face of good news."

"The market can stay irrational longer than you can stay solvent."
-John Maynard Keynes

"Government is best which governs least" - Thomas Jefferson

Inflation is the one form of taxation that can be imposed without legislation.
-Milton Friedman

"You cannot legislate the poor into freedom by legislating the wealthy out of freedom. What one person receives without working for, another person must work for without receiving. The government cannot give to anybody anything that the government does not first take from somebody else. When half of the people get the idea that they do not have to work because the other half is going to take care of them, and when the other half gets the idea that it does no good to work because somebody else is going to get what they work for,that my dear friend, is about the end of any nation. You cannot multiply wealth by dividing it." - Dr. Adrian Rogers, 1984

"Bear markets seem to be divided into three phases: the first being the abandonment of hopes upon which the final uprush of the preceding bull market was predicted; the second, the reflection of decreased earnings power and reduction of dividends, and the third representing distressed liquidation of securities which must be sold to meet living expenses. Each of these phases seems to be divided by a secondary reaction which is often erroneously assumed to be the beginning of a bull market."
- Robert Rhea

"Free enterprise is a rough and competitive game. Nobody too big to fail. Nobody too small to succeed. It is a hell of a lot better than government control." - Ronald Reagan via Dan Kennedy

"A government big enough to give you everything you want is big enough to take everything you have." - Gerald Ford via Dan Kennedy

"The problem with socialism is that, sooner or later, you run out of other people's money." - Margaret Thatcher

"Diversification alone is no longer sufficient to temper risk... You need something more to manage risk well."
- Mohamed El-Erian

"A little bit at a time adds up to a lot in no time"

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