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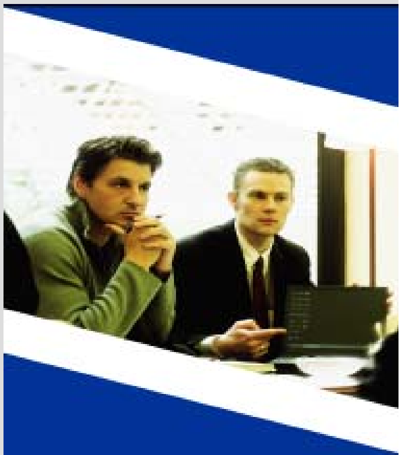

Sam Stovall
Chief
Investment Strategist

212-438-9549

sam_stovall@sandp.com

55 Water Street
New York, NY
10041

First-Half Flop, Second-Half Stumble? **July 19, 2010**

Sam Stovall, Chief Investment Strategist

The U.S. equity market action on Friday, July 16 – due to weaker-than-expected results for many of the market bellwethers, combined with less-than-encouraging economic data – may simply be a precursor of equity price performances for all of 2010. Michael Sheldon, the Chief Investment Strategist at RDM Financial, recently alerted me of an interesting market forecasting indicator. It's basically a twist on the "As goes January So Goes the Year" rule that states "if the Dow Jones Industrial Average falls in price in January and through mid-year, it will likely be down for the entire year." Of course I had to see if this indicator was true, not only for the S&P 500, but also for the sectors within the S&P 500. I found that it was accurate for both, and therefore may carry ominous implications for the market and nine of its 10 sectors this year.

A Price Decline in January and the First Half Typically Signal a Decline for the Full Year (1900-2009)

	% Changes (no dividends)			
Year	January	First Half	Second Half	Full Year
1907	(2.8)	(20.3)	(16.2)	(33.2)
1910	(2.1)	(11.7)	(0.5)	(12.1)
1913	(0.9)	(13.4)	(1.0)	(14.3)
1916	(1.6)	(1.3)	4.7	3.4
1917	(2.3)	(7.8)	(24.8)	(30.6)
1920	(1.0)	(11.2)	(14.0)	(23.7)
1932	(2.8)	(45.4)	55.5	(15.1)
1939	(6.9)	(17.8)	15.0	(5.5)
1940	(3.5)	(20.1)	6.0	(15.3)
1941	(4.8)	(6.9)	(11.8)	(17.9)
1953	(0.7)	(9.1)	2.8	(6.6)
1960	(7.1)	(5.0)	2.1	(3.0)
1962	(3.8)	(23.5)	15.3	(11.8)
1969	(0.8)	(5.9)	(5.8)	(11.4)
1970	(7.6)	(21.0)	26.7	0.1
1973	(1.7)	(11.7)	(6.4)	(17.4)
1974	(1.0)	(11.8)	(20.3)	(29.7)
1977	(5.1)	(6.5)	(5.4)	(11.5)
1981	(4.6)	(3.4)	(6.6)	(9.7)
1982	(1.8)	(10.6)	28.3	14.8
1984	(0.9)	(7.1)	9.2	1.4
1992	(2.0)	(2.1)	6.8	4.5
2000	(5.1)	(1.0)	(9.2)	(10.1)
2002	(1.6)	(13.8)	(11.1)	(23.4)
2005	(2.5)	(1.7)	4.8	3.0
2008	(6.1)	(12.8)	(29.4)	(38.5)
2010	(3.7)	(7.6)	???	???
Medians	**(2.5)**	**(10.6)**	**(0.8)**	**(11.7)**

Source: Standard & Poor's Equity Research.

Past performance is no guarantee of future results.

From 1900 through 2009, the S&P 500 declined in price 26 times in both January and in the first half of the year. During these 26 years, the market posted full-year declines 20 times, or 77% of the time, and recorded a median full-year drop of 11.7%. What's more, the market continued to fall during the second half in 14 years, or 54% of the time. In other words, should history repeat itself – and there is no guarantee it will – the S&P 500 has a three-in-four chance of posting a decline for all of 2010, and has a better than even chance of continuing its decline during the second half of the year.

So Go the Sectors, Too?

Taking this indicator one step further, I wondered how accurate it was since 1990 for the S&P 500 and its 10 sectors (which is as far back as sector data extend). I found the results to be eye-catching as well. First, there were five times that the S&P 500 declined in both January and through mid-year: 1992, 2000, 2002, 2005 and 2008. For the full year, the market was still down three times (2000, 2002 and 2008), or 60% of the time, and recorded a median full-year decline of 10.1%. During this same 20-year period, all 10 sectors in the S&P 500 experienced declines in January and through June from as little as twice (for Information Technology) to as much as nine times (for Utilities); Consumer Staples, Financials, Health Care, and Telecom Services saw "double downs" seven times, while Industrials participated in six observations. Once triggering this negative indicator, all sectors recorded median full-year declines from 1.9% (for Energy) to 22.6% (for Consumer Discretionary), and recorded correct full-year forecasts from 50% of the time (for Industrials, Info Tech, and Materials) to 75% for Energy, 86% for Health Care and 100% for Consumer Discretionary.

A Price Decline in January and the First Half Typically Signal a Decline for the Full Year, Even for Sectors (1990-2009)

Group	Average FY % Chg.	Correct Forecast	Num. of Observs.	Down '10 Forecast?
Consumer Discretionary	(22.6)	100%	4	Yes
Consumer Staples	(6.3)	57%	7	Yes
Energy	(1.9)	75%	4	Yes
Financials	(10.5)	57%	7	Yes
Health Care	(12.9)	86%	7	No
Industrials	(3.3)	50%	6	Yes
Information Technology	(21.7)	50%	2	Yes
Materials	(5.9)	50%	4	Yes
Telecommunication Services	(17.7)	71%	7	Yes
Utilities	(12.8)	67%	9	Yes
S&P 500	(10.1)	60%	5	Yes
S&P 500/Citigroup Growth	(0.6)	80%	5	Yes
S&P 500/Citigroup Value	(6.6)	67%	6	Yes

Source: Standard & Poor's Equity Research.
Past performance is no guarantee of future results.

Of course we all know that past performance is no guarantee of future results, but history does have a way of at least warning us to the possibility of further declines. And 2010 may be no exception. The S&P 500 declined in both January and through mid-year, as did nine of its sectors. The only one that history hints may close higher on the year is Health Care, which sounds logical if the S&P 500 is expected to remain in intensive care.

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55 Water Street
New York, NY
10041

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A+	Highest	B-	Lower
A	High	C	Lowest
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B	Below Average		

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CY- Calendar Year
DCF- Discounted Cash Flow
EBIT- Earnings Before Interest and Taxes
EBITDA- Earnings Before Interest, Taxes, Depreciation and Amortization
EPS- Earnings Per Share
EV- Enterprise Value
FCF- Free Cash Flow
FFO- Funds From Operations
FY- Fiscal Year
P/E- Price/Earnings
PEG Ratio- P/E-to-Growth Ratio
PV- Present Value
R&D- Research & Development
ROE- Return on Equity
ROI- Return on Investment
ROIC- Return on Invested Capital
ROA- Return on Assets
SG&A- Selling, General & Administrative Expenses
WACC- Weighted Average Cost of Capital

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55 Water Street
New York, NY 10041
(212) 438-2000

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