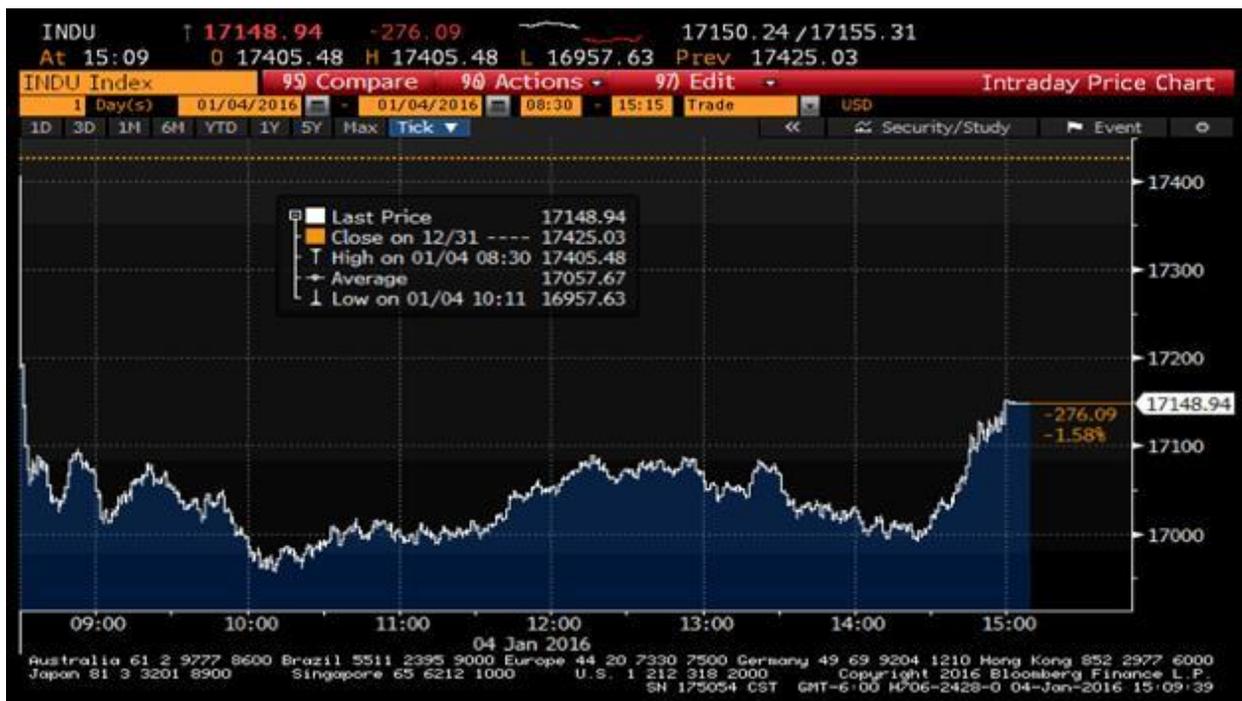


## Market Update – 1/4/2016

Written By: Doug Ciocca

Well, it is safe to say that Santa has officially left the building. Actually, I'm not sure that he bothered to enter the building this holiday season....given the dips in both the Dow Jones Industrial Average and S&P 500 of more than 1.5% in December of last year<sup>1</sup>.

And while this year began on a negative note, it was much more sour mid-morning than was the case @ the close. A little after 10am CT, the Dow had slipped over 467 points but managed to fight its way back to a less dramatic drop of 276.09 points, (see the chart below from Bloomberg Market Data).



As we see it, there were 3 catalysts to today's stock market action and below is a dissection of each:

### #1: *Weak Economic Data coming out of China*<sup>2,3</sup>:

- The Caixin Purchasing Managers Index (PMI) came in weaker than expected, falling to 48.2 in Dec, from 48.6 in Nov. Reuters estimate was 49.0.
- Caixin PMI focuses on small and medium sized companies and fills a niche that isn't covered by official data.
- The Caixin has been below 50 for 10 straight months but it well off the worst reading in July-September.
- Official PMI data released over the weekend was 49.7 for Dec, up from 49.6 in Nov and in line with Reuters forecast.

- Official non-manufacturing PMI rose to 54.4 in Dec, up from 53.6 in Nov
- Chinese industrial companies' profits fell 1.4% for the year ending in November, the sixth straight month of declines.
- China's economic growth dropped to 6.9% in Q3, below 7% for the first time since 08-09. IMF predicts 6.3% for 2016.
- It adds more volatility and unpredictability to an already volatile/unpredictable market.

### ***#2: Heightened Tension in the Middle East Between Saudi Arabia (SA) and Iran<sup>4,5</sup>:***

- SA cut diplomatic ties with Iran on Sunday following SA's execution of a Shi'ite cleric Sheikh and subsequent protests by Iranians and an attack of the SA embassy in Tehran, Iran.
- The execution was part of a mass execution of 47 prisoners on Saturday. The executed cleric was a leading voice behind the Arab Spring movement in 2011. The execution was one of the largest in decades in SA.
- SA gave Iranian diplomats 48 hours to leave the country.
- SA has taken a more aggressive approach toward Iran since King Salman came into power.
- It has increased involvement in Syria and is opposing the Iran-backed president there as well as in Yemen, where it is fighting Houthi rebels, also supported by Iran.
- Western governments made calls to restore diplomacy between the countries.
- Brent crude spiked as a result about 3% (we'll get a more exact figure for publish time). It adds volatility to an already volatile market.
- There was already an expectation for increased oil exports from Iran this year after sanctions being lifted but now there's questions over whether that could be delayed or happen at all.
- Saudis are in favor of continued high output to remain competitive, Iran wants to cut production.

### ***#3: A couple less-than-stellar domestic economic data points<sup>6</sup>:***

- The month-over-month Construction Spending Measure fell -0.4%. The expectation was for an increase of +0.6%.

- The December Institute of Supply Management (ISM) Manufacturing range registered a reading of 48.2 and the expectation was for a reading of 49.0. Readings below 50 signify contraction in the manufacturing sector, while readings above 50 are an indication of expansion this area of the economy.
- Both readings are not encouraging for the labor market, arguably the lynch pin for a sustained and broad-based economic expansion.

As you can imagine, little that takes place in markets, or really anything anymore, is unprecedented, and today's price action is no different. In fact, this is the 14<sup>th</sup> time since 1930 that the S&P 500 has fallen more than 1% on the first trading day of the year. And while that has an ominous feel to it, it has historically boded positively for the balance of the month. Now, granted, there is no guarantee that history will repeat itself, or rhyme, but it is interesting nonetheless that:

- Statistically, when the S&P 500 drops > 1% on the first day of the year, January is up a median +5% for the rest of the month. See tabular data below<sup>7</sup>.

S&P 500 Returns If First Day Of Year Is Down >1%			
Date	SPX	First Day Of Year	January After 1st Day
1/2/1930	21.18	-1.26%	7.60%
1/4/1932	7.56	-6.90%	4.37%
1/3/1933	6.83	-1.30%	1.61%
1/4/1937	16.93	-1.46%	5.32%
1/3/1949	14.95	-1.64%	1.81%
1/2/1957	46.20	-1.01%	-3.20%
1/3/1978	93.82	-1.35%	-4.87%
1/2/1980	105.76	-2.02%	8.85%
1/3/1983	138.34	-1.64%	5.03%
1/2/1985	165.37	-1.12%	8.62%
1/2/1991	326.45	-1.14%	5.35%
1/2/2001	1283.27	-2.80%	6.45%
1/2/2008	1447.16	-1.44%	-4.74%
		Average	3.25%
		Median	5.03%
		% Higher	76.92%

This is going to be an interesting year and we are flattered by your confidence in aligning with Kavar Capital as we make our way through 2016. We'll stay in close touch. dc

<sup>1</sup> Source: Bloomberg Market Data

<sup>2</sup><http://www.ft.com/fastft/2016/01/04/china-sets-renminbi-fix-at-6-5-per-dollar/>

<sup>3</sup><http://www.cnbc.com/2016/01/03/asian-markets-set-for-cautious-open-china-caixin-pmi-due.html>

<sup>4</sup><http://www.wsj.com/articles/oil-rises-in-asia-due-to-iran-saudi-arabia-tensions-1451875967>

<sup>5</sup><http://www.wsj.com/articles/irans-supreme-leader-vows-divine-revenge-for-saudi-execution-of-shiite-cleric-1451817615>

<sup>6</sup> Source: Bloomberg Market Data

<sup>7</sup> <https://twitter.com/RyanDetrick/status/684002374604603392>

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