Federated Hermes

A coronavirus curveball for January barometer

Looking through the virus' late January impact, we still see strong year for S&P.

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BOTTOM LINE

Stocks shot from the gate to start 2020, with the S&P 500 rallying 2.93% over the first three weeks of January, setting a new record high on Jan. 22. But as investors began to learn about the coronavirus outbreak in China (COVID-19) in mid-January, stocks reversed course in a heartbeat. They fell 3.01% through month-end, wiping out a positive full January, which ended marginally lower with a nominal decline of 0.16%.

Based upon its revised data-collection methodology announced Wednesday, China now believes that the virus' mortality rate peaked on Jan. 26 at 5.34%. But through Wednesday, 48,206 people had been confirmed sick and 1,310 had died, shrinking the mortality rate by half to 2.71% on Feb. 12. Contrast that with the SARS epidemic that raged from November 2002 to July 2003. 8,098 were confirmed sick in that span and 774 were killed, but the mortality rate was a much higher 9.56%.

Consequently, the S&P rebounded 4.68% from the end of January to yesterday's record high at 3,385, as investors now seem to believe the mortality rate will not get materially worse. From the beginning of the year through today, stocks have rallied by a powerful 4.52%, overcoming what appears to be a temporary COVID-19 speed bump.

To be sure, we could still see a 5-8% air pocket in coming months, due to renewed concerns about the virus, its impact on Chinese economic growth and the trading relationship with the U.S. In addition, Boeing could hit a pothole on its runway to return to flight, and our contentious presidential election may take a surprising twist (perhaps during what could be a contested Democratic convention in Milwaukee in mid-July). Regardless, we would use any weakness as an attractive longer-term buying opportunity. We still expect stocks to enjoy a strong second-half rally that will lift the S&P up to or beyond our 3,500 full-year target.

Strong adjusted positive "January Barometer" signal for 2020 On the surface, the S&P suffered through a marginally negative January, falling 0.16% for the full month on a price-only basis (down 0.04% on a total-return basis). The "January Barometer" remains one of the stock market's most popular and widely followed rules of thumb. Historically, as the month of January goes, so goes the full year. Since 1950, Jeffrey and Yale Hirsch at the Stock Trader's Almanac report that when the index started the New Year with a negative month of January, as it has now done 27 times (not including this year), the odds of a positive full year are no better than a coin flip at 48%.

But when January is a positive month, as it has been 43 times since 1950, it finished the year higher in 38 of those instances, for a strong success rate of

88%. Looking back, then, over the equity market's first 45 days in 2020, we're inclined to overlook the six trading days at the end of January in which the S&P shed 3% of its value, in a typical knee-jerk reaction to the unsettling news about COVID-19.

Fundamentals driving the bus The first week in February posted a slug of sharply positive economic developments that helped to right a ship that had been listing from news of the coronavirus and led stocks back into positive territory:

- ISM manufacturing index: after languishing in contraction territory since July, it spiked to a stronger-than-expected 50.9 in January.
- ADP: Private payrolls surged by 291,000 in January, a 5-year high.
- Initial weekly jobless claims: Claims plunged by 50,000 over the previous two months through the week ended Feb. 1.
- Nonfarm payrolls: The largest of the employment measurements was stronger than expected, reporting a gain of 225,000 jobs in January, compared with a consensus estimate of only 165,000 jobs.
- Labor force participation rate: This important measure rose to a 7-year high of 63.4% in January.

Political uncertainty rises A series of election-related developments in the first week in February added to the confusion:

- Iowa caucuses: Due to several technology glitches, we still don't know who won.
- State of the Union speech: While President Trump delivered a strong speech, Speaker Pelosi's shredding of his text was widely viewed as disrespectful to the office of the president.
- Impeachment acquittal: The Senate voted to acquit President Trump in a vote that closely hewed to party lines.

- New Hampshire Debate: Former Vice President Joe Biden, one of the front-runners, performed poorly, while Senator Amy Klobuchar (Minn.), an underdog, performed well.

What are the best sectors to own in 2020? The “January Barometer Portfolio” indicator also holds that the best- and worst-performing S&P sectors in January tend to follow that performance trend the rest of the year. Here are the 11 sectors, sorted by their total-return performance in January 2020. The results are a mixed bag, with a combination of defensive, dividend-oriented stocks, growth stocks and cyclicals in the top half of the list:

- Utilities, 6.65%
- Information technology, 3.96%
- REIT’s, 1.42%
- Communication services, 0.92%
- Consumer discretionary, 0.63%
- Consumer staples, 0.36%
- S&P 500, -0.04%
- Industrials, -0.45%
- Financials, -2.58%
- Health care, -2.72%
- Materials, -6.17%
- Energy, -11.07%

Happy 21st Valentine’s Birthday, Jen!

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DISCLOSURES

Views are as of the date above and are subject to change based on market conditions and other factors. These views should not be construed as a recommendation for any specific security or sector.

Gross Domestic Product (GDP) is a broad measure of the economy that measures the retail value of goods and services produced in a country.

S&P 500 Index: An unmanaged capitalization-weighted index of 500 stocks designated to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. Indexes are unmanaged and investments cannot be made in an index.

Past performance is no guarantee of future results.

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