VOLATILITY: FOREWARNED IS FOREARME

One Third of All Monthly Declines of 5% or More Occurred in Aug. & Sept.

July is over. Heat and humidity are on the rise, and so is the distress among many children who realize that they will soon have to go back to school. Investors are also likely to begin experiencing a rising level of agita as they are reminded that large-cap U.S. stocks have gained nearly 19% since the February 11 bottom but are now entering the most volatile period of the year as August and September are ranked 11 and 12 in terms of monthly price increases since WWII. Yet forewarned is forearmed. Investors who are aware that the market traditionally stumbles during these two months are less likely to become their portfolios' worst enemies by reacting emotionally. Rather, we believe investors would be better off buying than bailing, and advise building a “wish list” of stocks to own.

July Reprise

During this past July, the S&P Composite 1500, which consists of the S&P 500, MidCap 400 and SmallCap 600, gained 3.7% in price, and saw price increases of 3.6% for its large-cap component, 4.2% for its mid-cap members and 5.0% for its holdings in small caps. In addition, seven of its 10 sectors rose in price, led by Tech (+7.6%), Materials (+5.4%) and Health Care (+4.9%). Laggards were led by Consumer Staples (-0.7%), Utilities (-0.8%) and Energy (-2.0%). Finally, 80% of the 149 sub-industries in the S&P 1500 rose in price during July, led by 20%+ gains for the Coal, Consumer Electronics and Precious Metals groups, while declines in excess of 4% were registered by Food Retail, Marine and Oil & Gas Drilling.
Seasonal Tsunamis
August and September have traditionally been the worst months for stock-price returns. Maybe it’s because of reduced capital inflows, vacations, upcoming earnings reality, and Mutual Funds’ fiscal year-end window dressing. Whatever the reasons, the results are unmistakable. August and September have recorded the worst two average price performances since 1945. Indeed, while the S&P 500 rose in price in nearly 60% of all months, it advanced only 54% of the time in August and fell more times than it rose in September. These two months recorded the 2nd and 3rd deepest single-month declines of 11.9% in November 1974 and 14.6% in August 1998. Only October 1987’s drop of 21.8% and October 2008’s slump of 16.9% were worse. Also, they are in the top 1/3rd of months with the highest standard deviation, or variation, of price returns.

Finally, the S&P 500 recorded one-third of its monthly declines of 5% or more in August and September since 1945, with each registering 17% of all such declines. This performance further confirms the negative volatility typically experienced in the six months from May through October. Indeed, each month within the “Sell in May” period recorded 11% of all monthly declines of 5% or more, versus an average 6% frequency for each month in the November through April period.

Sector Softness
Seasonal softness is not reserved solely for the benchmark, but has been pronounced at the sector level as well. Since 1990, which is as far back as S&P Dow Jones Indices’ sector-level data extend, the S&P 500 fell in price an average of nearly 1% during the third quarter, while seven out of its 10 sectors also recorded average price declines, led by Industrials (-1.3%), Consumer Discretionary (-1.8%) and Materials (-2.6%). Only the defensive Consumer Staples (+0.6%), Health...
Care (+0.8%) and Utilities (+0.6%) groups posted positive results. However, as stated earlier, these returns are no reason to run, but rather to await price-decline opportunities since the S&P 500 jumped an average of 5.0% in Q4, and saw positive returns for all 10 of its sectors. Q4 return leaders were Tech (+6.6%), Consumer Discretionary (+6.3%) and Consumer Staples (+6.3%). What’s more, the weakest average sector returns were still positive for Energy (+1.9%), Utilities (+2.8%) and Telecom (+4.5%).

**Buy Recommendations**

So which beaten-up stocks look attractive today (and maybe even more so, should the market suffer a set-back)? Nine stocks were identified using the screening capability of S&P Global’s MarketScope Advisor platform. All carry S&P Global 5-STARS rankings (Strong Buy) and are currently trading at least 30% below their 52-week highs. The stocks are Anadarko Petroleum (APC), Blackstone Group L.P. (BX), Gilead Sciences (GILD), Harman Intl (HAR), JetBlue Airways (JBLU), Lions Gate Entertainment (LGF), Magna International (MGA), Mosaic Co (MOS), and Skechers U.S.A. Cl’A’ (SKX).

**Conclusion**

So there you have it. The S&P has gained nearly 19% since the February 11 bottom. Is it in need of a breather? Should the S&P 500 record a digestive decline in the coming two months, it would occur in a period most closely identified with poor stock market and sector performances. August and September are ranked 11 and 12 in terms of monthly price increases since WWII. They recorded the 2nd and 3rd deepest single-month declines, and are in the top 1/3rd of monthly volatility. Also, the S&P 500 recorded one-third of all monthly declines of 5% or more in August and September. Finally, the S&P 500 fell in price an average of nearly 1% during Q3 since 1990, while seven out of its 10 sectors also recorded average price declines. Yet forewarned is forearmed. Investors who are aware that the market traditionally stumbles during these two months are less likely to become their portfolios’ worst enemies. Rather, we believe they would be better off buying than bailing and list nine stocks that are trading more than 30% below their 52-week highs, yet carry Strong Buy recommendations by S&P Global’s equity analysts.

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**5-STARS Stocks Trading More than 30% Below Their 52-Week Highs**

<table>
<thead>
<tr>
<th>Sector</th>
<th>Company</th>
<th>Ticker</th>
<th>Price</th>
<th>Price to 52 Week High</th>
<th>Yield</th>
</tr>
</thead>
<tbody>
<tr>
<td>Consumer Disc.</td>
<td>Harman Intl</td>
<td>HAR</td>
<td>82.64</td>
<td>0.69</td>
<td>1.7</td>
</tr>
<tr>
<td>Consumer Disc.</td>
<td>Lions Gate Entn</td>
<td>LGF</td>
<td>19.99</td>
<td>0.48</td>
<td>1.8</td>
</tr>
<tr>
<td>Consumer Disc.</td>
<td>Magna International</td>
<td>MGA</td>
<td>38.57</td>
<td>0.69</td>
<td>2.5</td>
</tr>
<tr>
<td>Consumer Disc.</td>
<td>Skechers U.S.A. Cl’A’</td>
<td>SKX</td>
<td>24.02</td>
<td>0.44</td>
<td>Nil.</td>
</tr>
<tr>
<td>Energy</td>
<td>Anadarko Petroleum</td>
<td>APC</td>
<td>54.53</td>
<td>0.69</td>
<td>0.4</td>
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<tr>
<td>Financials</td>
<td>Blackstone Group L.P.</td>
<td>BX</td>
<td>26.84</td>
<td>0.67</td>
<td>6.5</td>
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<td>Health Care</td>
<td>Gilead Sciences</td>
<td>GILD</td>
<td>79.47</td>
<td>0.66</td>
<td>2.4</td>
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<td>Industrials</td>
<td>JetBlue Airways</td>
<td>JBLU</td>
<td>18.33</td>
<td>0.67</td>
<td>Nil.</td>
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<tr>
<td>Materials</td>
<td>Mosaic Co</td>
<td>MOS</td>
<td>27.00</td>
<td>0.60</td>
<td>4.1</td>
</tr>
</tbody>
</table>

Glossary

★★★★★ 5-STARS (Strong Buy):
Total return is expected to outperform the total return of a relevant benchmark, by a wide margin over the coming 12 months, with shares rising in price on an absolute basis.

★★★★☆ 4-STARS (Buy):
Total return is expected to outperform the total return of a relevant benchmark over the coming 12 months, with shares rising in price on an absolute basis.

★★★☆☆ 3-STARS (Hold):
Total return is expected to closely approximate the total return of a relevant benchmark over the coming 12 months, with shares generally rising in price on an absolute basis.

★★☆☆☆ 2-STARS (Sell):
Total return is expected to underperform the total return of a relevant benchmark over the coming 12 months, with shares not anticipated to show a gain.

★☆☆☆☆ 1-STAR (Strong Sell):
Total return is expected to underperform the total return of a relevant benchmark by a wide margin over the coming 12 months, with shares falling in price on an absolute basis.

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A+ Highest
A High
A- Above Average
B+ Average
B Below Average
B- Lower
C Lowest
D In Reorganization

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