Annual Forecast Model For The Dow - 2017

February 5, 2017:

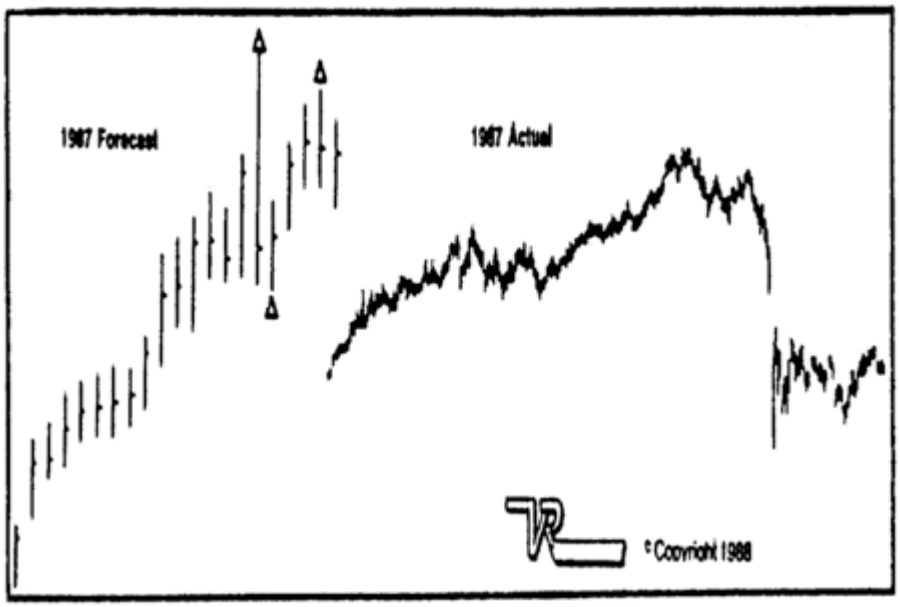
I start my Annual Forecast Model report the same away each year, so need to change after twenty-nine years. A picture is worth a thousand words, so I will try and keep my commentary brief. But, first, some background for new subscribers.

Thank you once again for subscribing to The VR Forecaster (Annual Forecast Model) - published annually since 1987. It is, in fact, the success of 1987 Model that set the stage for all future reports. The rudimentary chart of the 1987 Model (below) which was published in January 1987 warned of some significant volatility for the October ahead, and in my January commentary I stated:

> *"What does 1987 hold in store? Well, if a picture is worth a thousand words, this one should be clear: We're going up! But watch out for that nasty step scheduled around early October."*

Well, we all know that 'nasty step' was the 1987 Crash and the rest is history. The financial press provided me with some recognition at that time. I recall while on the Wall Street with Louis Rukeyser program in September 1987 stating that something was coming by the third week of October, though I was cautiously bullish up until that time. Of course, early October saw a sharp reversal to the downside with a one-day 90 point decline which was huge for 1987. That changed everything, and the Annual Forecast Model was very much in sync.

1987 Chart



For years, the various 'Bellwether' rules and axioms for predicting the future course of the stock market have been freely bandied about and in most stances were regarded as nothing more than curiosities without any real or practical application. Students of these bellwether indicators, however, take them more seriously and usually have statistics backing them up when presenting their conclusions. Examples of such bellwether applications include the Super Bowl Indicator, the General Motors Bellwether Theory, the Hemline Indicator and, the Swimsuit Indicator, the Presidential Election Cycle, Groundhog Day, the Halloween Indicator, and, of course, the January Barometer. In addition, I have added a few other more 'entertaining' economic indicators this year for your perusal.

THE JANUARY BAROMETER

Devised by Yale Hirsch in 1972, the January Barometer has registered eight major errors since 1950 for an 87.9% accuracy ratio. This indicator adheres to propensity that as the S&P 500 goes in January, so goes the year. Of the eight major errors, Vietnam affected 1966 and 1968. 1982 saw the start of a major bull market in August. Two January rate cuts and 9/11 affected 2001.The market in January 2003 was held down by the anticipation of military action in Iraq. The second worst bear market since 1900 ended in March of 2009 and Federal Reserve intervention influenced 2010 and 2014. Including the eight flat years yields a .758 batting average.

While authoring the fascinating Stock Trader's Almanac. Yale, by the way, was kind enough to dedicate his 1987 edition of this almanac to me and three other technical analysts calling us the 'New Prognosticators.' That was a great personal honor for me, especially since the Stock Trader's Almanac was the first book I ever read back in college regarding the stock market.

1933 "Lame Duck" Amendment - Why JB Works

All detractors refuse to accept the fact the January Barometer exists for one reason and for one reason only: the Twentieth "Lame Duck" Amendment to the Constitution. Passage of the Twentieth Amendment in 1933 created the January Barometer. Since then it has essentially been "As January goes, so goes the year." January's direction has correctly forecasted the major trend for the market in most of the subsequent years.

Prior to 1934, newly elected Senators and Representatives did not take office until December of the following year, 13 months later (except when new Presidents were inaugurated). Defeated Congressmen stayed in Congress for all of the following session. They were known as "lame ducks."

Since 1934, Congress convenes in the first week of January and includes those members newly elected the previous November. Inauguration Day was also moved up from March 4 to January 20.

January's prognostic power is attributed to the host of important events transpiring during the month: new Congresses convene; the President gives the State of the Union message, presents the annual budget and sets national goals and priorities.

These events clearly affect our economy and Wall Street and much of the world. Add to that January's increased cash inflows, portfolio adjustments and market strategizing and it becomes apparent how prophetic January can be. Switch these events to any other month and chances are the January Barometer would become a memory.

JB vs. All

Over the years there has been much debate regarding the efficacy of our January Barometer. Skeptics never relent, and we don't rest on our laurels. Disbelievers in the January Barometer continue to point to the fact that we include January's S&P 500 change in the full-year results and that detracts from the January Barometer's predictive power for the rest of the year. Others attempt to discredit the January Barometer by going further back in time: to 1925 or 1897 or some other arbitrary year.

After the Lame Duck Amendment was ratified in 1934, it took a few years for the Democrat's heavy congressional margins to even out and for the impact of this tectonic governing shift to take effect. In 1935, 1936 and 1937, the Democrats already had the most lopsided Congressional margins in history, so when these Congresses convened it was anticlimactic. Hence our January Barometer starts in 1938.

Now for the even better news: In the 47 up Januarys, there were only three major errors for a 93.6% accuracy ratio. These years went on to post 15.8% average full-year gains and 11.5% February-to-December gains.

Another myth is that the January Barometer is completely useless. Those that believe this like to point out that simply expecting the market to be higher by the end of the year is just as accurate as the January Barometer. Statistically, they are just about right. In the 75-year history examined in this article, there were only 22 full-year declines. So yes, the S&P 500 has posted annual gains 70.7% of the time since 1938. What is missing from this argument is the fact that when January was positive, the full year was also positive 89.4% of the time and when January was down the year was down 60.7% of the time. We also know from above, that every down January on the S&P 500 since 1938, without exception, has preceded a new or extended bear market, a 10% correction, or a flat year.

By entirely ignoring the January Barometer, a trader or investor is simply accepting they will lose money 29.3% of the time based upon the historical performance of the S&P 500. How many parents or guardians would be satisfied knowing that 70.7% is the best their kid could do in school, ever? So why would it be acceptable in trading? It's not. Although the January Barometer is not 100% accurate, it does provide an advantage over simply guessing "higher" every year, increasing your odds at making money and perhaps even more important, not losing money. We'll continue to delve deeper into the January Barometer (and other indicators), but for now, we are content that its results will refute any representations to the contrary.

FIRST 5 DAYS VS. END OF MONTH

- SPX CLOSED 2016 AT 2238.83
- SPX FIRST FIVE DAYS 2017 CLOSE AT 2268.90
- SPX CLOSE OF JANUARY 2017 AT 2278.87
- CONCLUSION: MODESTLY BULLISH!

- RULE: FIRST FIVE DAYS EARLY WARNING.
- RULE: CLOSE OF JANUARY CONFIRMATION.

THE PRESIDENTIAL CYCLE

TE PRESIDENTIAL CYCLE

Election years are the second-best year of the four-year cycle and sixth years of decades have been up double digits four in a row, so 2016 has some solid history behind it. “Eighth years of presidential terms represent the worst of election years since 1920. In eighth years, the DJIA has suffered an average decline of –13.9%. As a result, eighth years have vastly differed from the typical election-year pattern.

Bull markets tend to occur in the third and fourth years of presidential terms while markets tend to decline in the first and second years. The ‘making of presidents’ is accompanied by an unsubtle manipulation of the economy. Incumbent administrations are duty-bound to retain the reins of power. Subsequently, the ‘piper must be paid,’ producing what we have coined the ‘Post- Presidential Year Syndrome.’ Most big, bad bear markets began in such years. Our major wars also began in years following elections. Post-election 2001 combined with 2002 for the worst back-to-back years since 1973–1974. Plus, we had 9/11, the war on terror, and the build-up to confrontation with Iraq.

Researchers have looked at this issue from a lot of different angles: Do equity markets prefer a Democratic or a Republican president? Is a victory by an incumbent or a challenger better? What about a divided versus a cohesive Congress?

Not all of this research has yielded actionable insights. Stock returns are the result of many different factors, so it’s not always possible to establish a direct link between developments in the stock market and the world of politics.

Nevertheless, we have been able to identify a few historical patterns in how markets have fared during different phases of the “election cycle,” or the four years leading up to each election. Of course, what happened in the past isn’t necessarily a guide to what will happen in the future, and the question of why such patterns exist remains a subject of debate. But traders may still find it interesting to take a closer look.

Breaking down the cycle

We looked at how the benchmark S&P 500® Index performed during presidential election cycles going back to 1950 and found the last year of the cycle—that is, the actual election year—has generally been good for equities.[1] The S&P 500 rose 81% of the time and posted an average return of 6.6%.

It’s worth pointing out that these results include the most bearish election year in the data set, 2008, when the S&P 500 dropped 37%. That year coincided with the collapse of Lehman Brothers and saw some of the worst losses of the recent financial crisis.

Market performance by year in election cycle

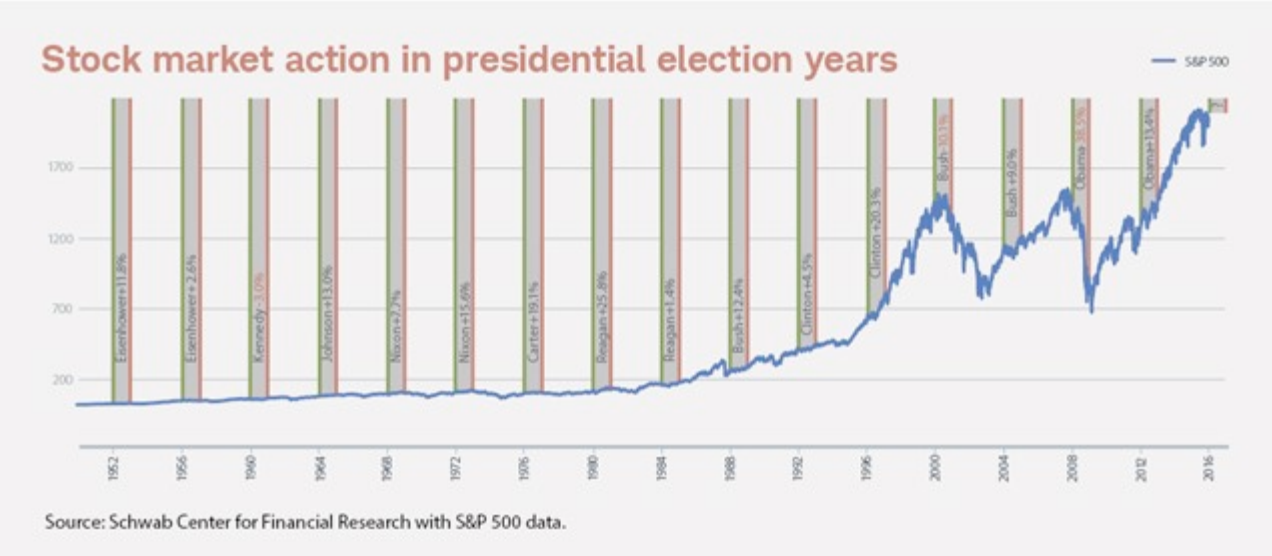
	ELECTION YEAR	ELECTION YEAR + 1	ELECTION YEAR + 2	ELECTION YEAR + 3
Number of up years	13	9	11	15
Number of down years	3	7	6	2
Average return	6.6%	6.5%	7.0%	16.4%

Source: Schwab Center for Financial Research with S&P 500 data from 1/1/1950 through 12/31/2015.

The first year of the cycle, which coincides with the first year of the presidential term, has historically been the toughest environment for stocks. In the 16 cycles studied, only nine finished with the S&P 500 in the black. This 56% success rate is only marginally better than a coin flip, though the 6.5% average return in those years compares favorably with rates in other years of the cycle.

The third year of the cycle—the year before the actual election—was generally the best one for equities. They rose in the third year in all but two of the 17 cycles covered by our research, delivering average returns of 16.4%.

The chart below shows the S&P 500 at the start (green line) and finish (red line) of each presidential election year since 1950.



If we drill down into this data a little further, we can see that different sectors tend to do well at different points in the election cycle. Historical data comparing sector performance isn't available as far back as the data for overall market performance, but we do have figures going back to 1992, giving us 23 years of information to analyze.

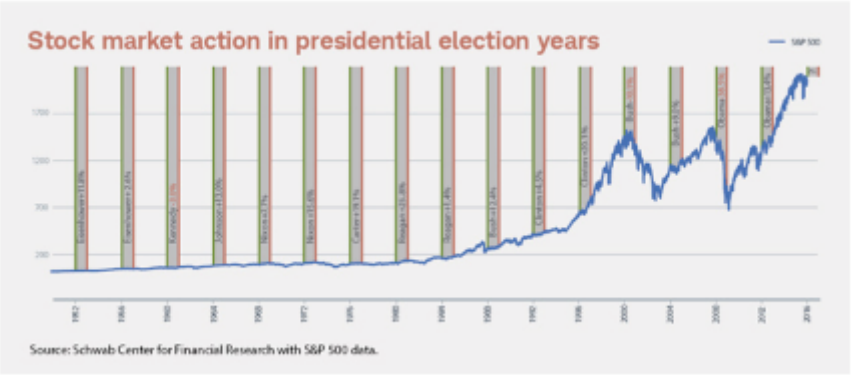
As you can see in the table below, the financial sector has been the top performer during election years, followed by utilities. Why the relative outperformance? Both of these sectors are highly regulated. Perhaps very little gets done politically during election years, meaning that there are likely to be fewer new regulations for these sectors than in other years. But again, politics and elections aren't the only factors affecting sector returns.

Consumer staples, energy and health care have also done reasonably well in election years.

Sector performance in election cycle

	ELECTION YEAR	ELECTION YEAR + 1	ELECTION YEAR + 2	ELECTION YEAR + 3
Financials	8.8%	15.7%	4.5%	8.1%
Utilities	6.2%	3.7%	0.3%	12.8%
Consumer staples	6.1%	8.5%	8.3%	10.2%
Energy	4.6%	13.9%	2.4%	19.9%
Health care	4.5%	13.1%	10.4%	14.3%
Industrials	3.5%	14.9%	3.2%	18.5%
Consumer discretionary	1.1%	19.9%	9.4%	13.7%
Materials	–3.5%	14.7%	4.7%	16.7%
Information technology	–4.3%	18.3%	15.7%	36.1%
Telecom-munications	–6.0%	5.7%	7.9%	13.5%

Source: Strategas Research Partners using S&P 500 data from 1/1/1992 through 12/31/2014.
Past performance is no guarantee of future results.



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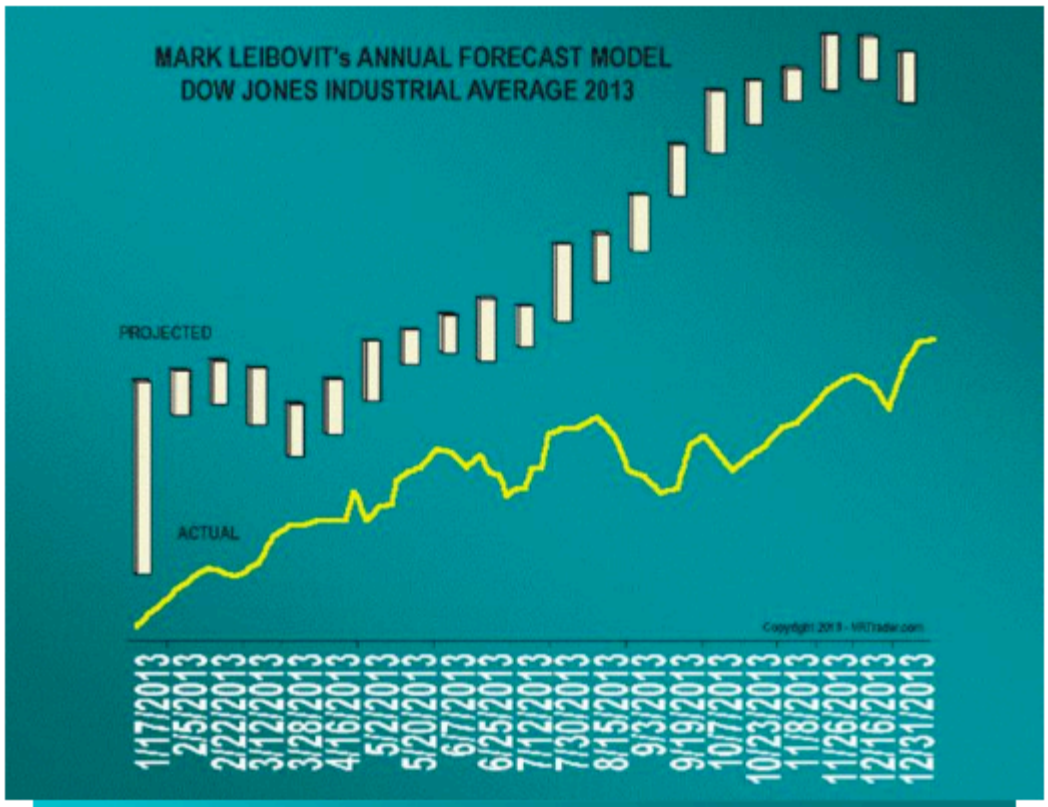
BACKGROUND OF THE ANNUAL FORECAST MODELS

Please keep these reports confidential. You have paid quite a bit of money to see them. The more eyes that see it, the less reliable it will ultimately become. However, even though I reserve the right to show small pieces of the AFM in the media for promotional purposes, especially historical results. It has been shown on the Nightly Business Report on PBS, the Business News Network (BNN) in Canada, at the Trader's Expo in Las Vegas or at the World Economic Conference in Vancouver, B.C.

The following comment may sound extraordinary, but years ago I was informed by a famous 'anonymous' source that My Annual Forecast Model may be replication of either the Federal Reserve System Model or perhaps the Plunge Protection Team 'Model' for market in the year ahead. He even suggested that perhaps they may even be using my 'Model'. How about that?

Please keep in mind this is a business where analysts such as myself who developed incredible multi-year or decade track records are judged solely by their 'last' trade. In other words, you're a bum if you're last trade was a bad call to the detriment of all your previous work. New or novice investors or those only seeking to eek out short-term gains may by chance acquire access to this 'Model' at a moment it gets out of sync and judge it harshly. Those of you, however, who have tracked these reports for several years know differently. No one can be perfect all the time and this report provides 'value-added' to your own research and insight. Regardless of whether the current signals (especially the Dow Industrials below) pan out or not, I'm sticking with the AFM, as it has served me well for over twenty years and placed my name at the top of market-timers in the United States.

PAST PERFORMANCE DOES NOT GUARANTEE FUTURE RESULTS


MARK LEIBOVIT's ANNUAL FORECAST MODEL
DOW JONES INDUSTRIAL AVERAGE 2013
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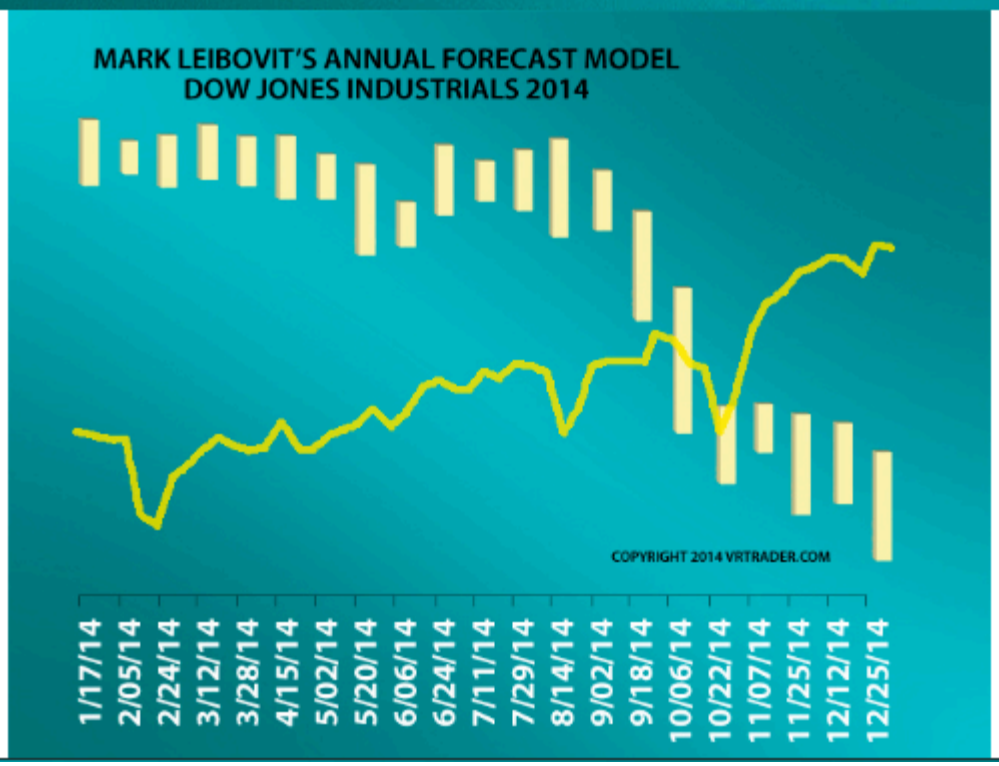
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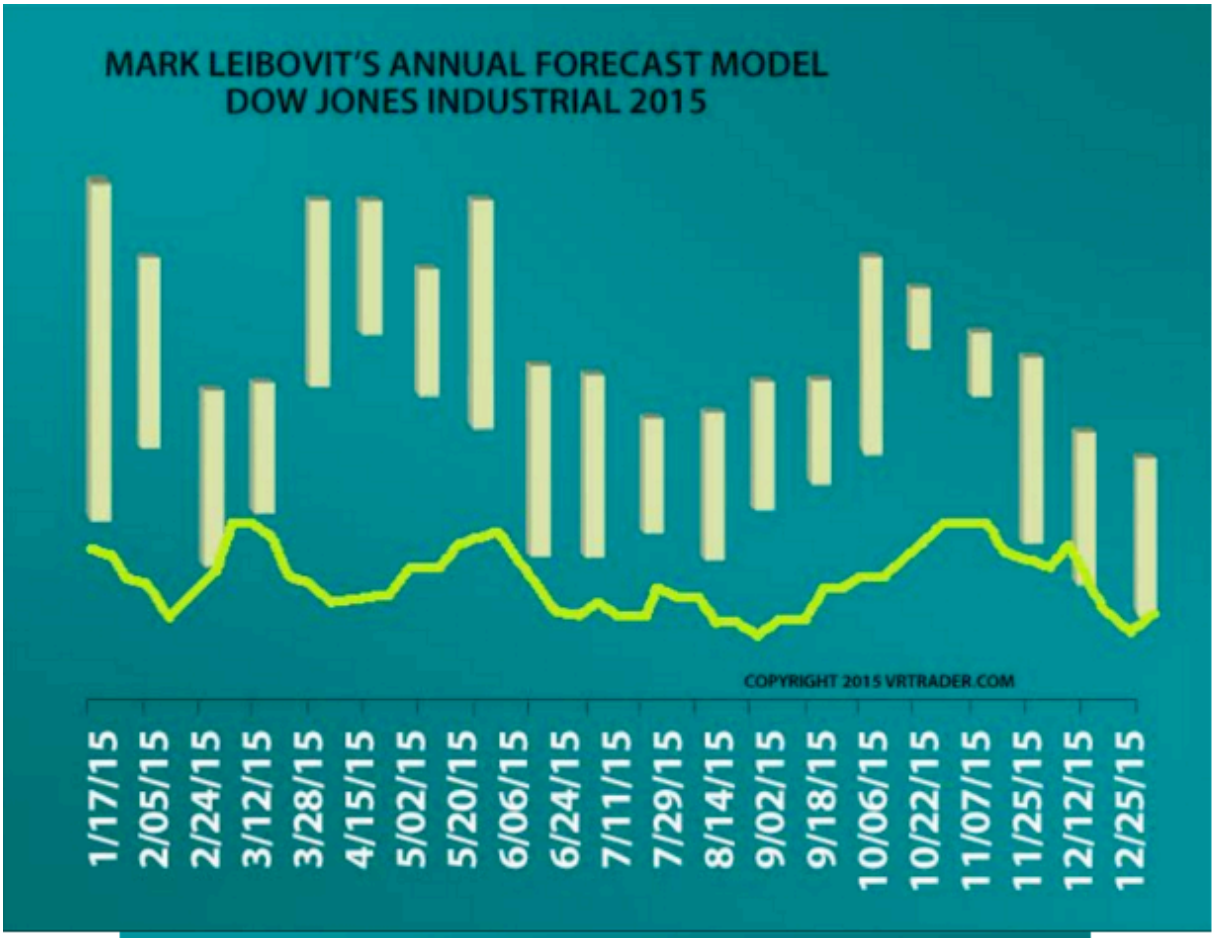
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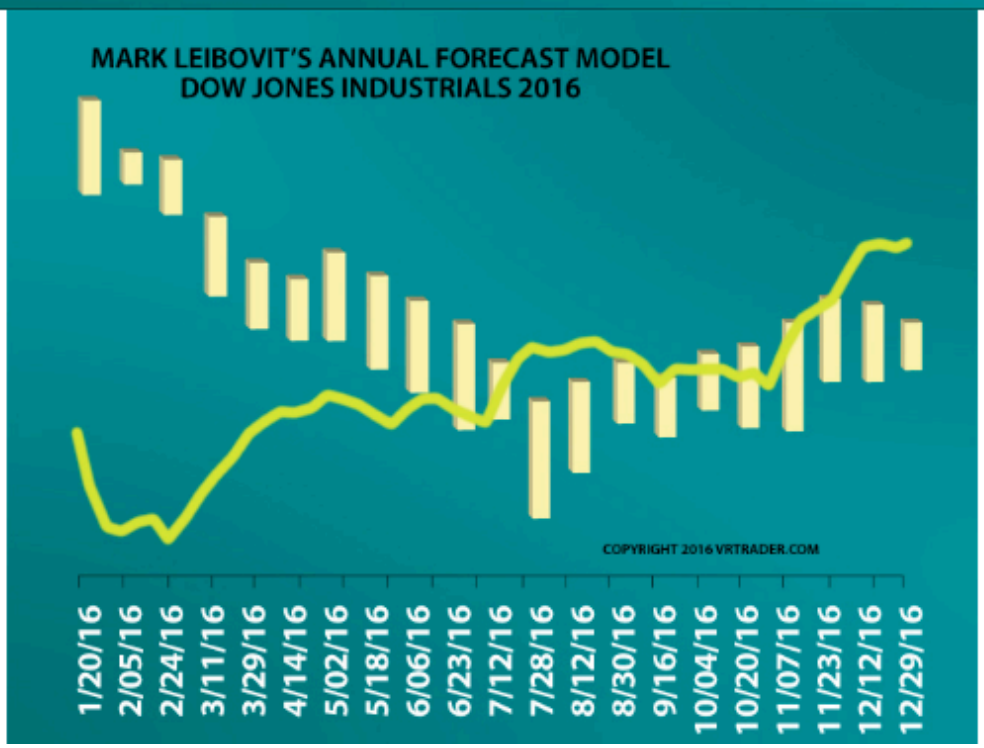
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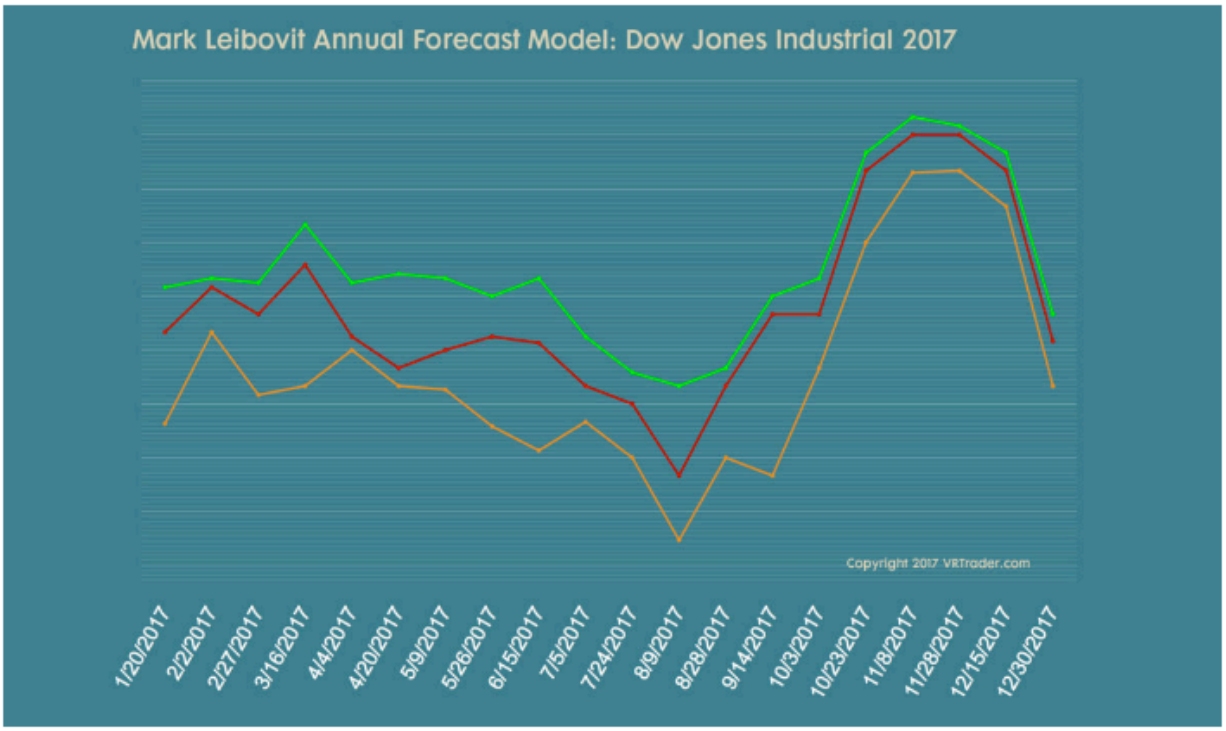

In the full report, AFMs for Crude Oil, Gold, U.S. Dollar Index, U.S. Treasury Bonds, Natural Gas and Copper are presented. A special offer for the full report will be coming soon thru Moneytalks.net!

Mark Leibovit, VRtrader.com