The 2013
S&P Outlook

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Table of Contents

1. **The 2013 TOY Story 4**
2. **The 2013Tape Story.. 6**
3. **2013 Election Cycle Analysis 8**
4. **2013 Interest Rate Considerations 9**
5. **The 2013 S&P Forecast 9**

2013 S&P Outlook Overview

In the following paper, I will outline the factors which contribute to our opinion that the odds favor a better than average return for the S&P in 2013. In summary, those factors include the following featured factors.

1. **Our research suggest that the manner in which the S&P turns the corner of the year is an incredibly important signal as to what one can anticipate for the remainder of the year. The period in which we focus on is the time frame from November 19 – January 19. The S&P's return of 9% in 2013, during this time period, which we refer to as the TOY (Turn of the Year) falls in what we consider to be the Goldilocks zone for this measure which is very important in our work.**

2. **On Dec 31, 2012, an agreement was reached in the budget stalemate and the S&P responded with an impressive two day advance, in which Up Volume constituted 95.92% of volume on the S&P 500. This falls in the range of previous levels which have a perfect record of forecasting an up market over the next six months.**

3. **We feel that although equities prices relative to their earnings, appear at first glance to be expensive, given the fact their primary competition comes from interest bearing securities and the return via the earnings of equity ownership is more attractive than the historically low returns available on interest bearing securities.**

The 2013 Toy Story

Owing largely to previous students of seasonal tendencies such as Yale Hirsch and Arthur Merrill, astute traders have for several decades been cognizant of the intermediate implications arising from the market's observed disposition at the 'Turn of the Year'. For the last half century, indicators such as the 'January Barometer', the 'First Five Days of January', and various 'End of the Year' holiday studies have served to document these tendencies.

In March of 2012, in an effort to finally resolve, for my own satisfaction, which time period was the King Pin of seasonal barometers, I implored my computer to take a few seconds to exhaustively study S&P performance over every time period of the year and determine which time frame's behavior was proprietor of the highest correlation coefficient relative to the following year's performance. My machine was kind enough to inform me there are many time periods which merit observance, and I am now the beneficiary of his daily capsulation of statistically significant time frames which are in play on any day of inquiry. Of current interest, the time period which this endeavor found to have the highest correlation to the following year, was the 2 month period from November 19 to January 19.

Since this two month time period (Nov19-Jan19) extends across the Turn of the Year (TOY) and encompasses the gift giving season, I have coined it the 'TOY Barometer'. The TOY Barometer's predictive ability benefits from the fact it's setup period includes several subset time frames which have, in their own right, shown predictive capability; such as the Thanksgiving Holiday Week, the Christmas Holiday Week, the Last Week of the Year and the First Week of the Year. The market's response to fourth quarter earnings announcements beginning in the second week of January could contribute as well. Also, many an investment methodology involves turn of the year contributions which may tip the market's hand as to levels of money flow which may follow throughout the course of the year.

The S&P booked a 2013 TOY of 7.14%. Since 1950, the S&P has finished positive in the following year (Jan19-Jan19) in 31 of those 32 years in which TOY performance exceeded 3%. In the 1987 exception, the S&P was up 24% from January 19 through August 13, before succumbing to an assault on double digit interest rates during the fall of that, the year of our Black Monday. The 32 previous +3% TOY cases are listed below for your viewing pleasure.

ONE YEAR (JAN19-JAN19) S&P PERFORMANCE AFTER A 3% TOY

#	YEAR	TOY%	NEXTYR%	#	YEAR	TOY%	NEXTYR%	#	YEAR	TOY%	NEXTYR%
1	1950	4.26	26.62	12	1971	13.09	10.79	23	1989	7.67	18.21
2	1951	7.55	13.53	13	1972	13.39	14.34	24	1991	4.04	26.08
3	1952	6.69	7.30	14	1975	4.05	36.70	25	1992	10.39	4.37
4	1954	5.25	36.14	15	1976	9.27	5.62	26	1997	4.58	23.88
5	1955	4.51	25.06	16	1979	5.64	11.35	27	1999	8.53	16.39
6	1958	3.24	35.79	17	1980	6.56	21.34	28	2004	9.34	3.92
7	1959	4.66	2.86	18	1983	6.02	14.99	29	2009	5.40	33.63
8	1961	7.08	15.02	19	1985	5.05	21.66	30	2010	5.05	11.45
9	1963	8.96	17.46	20	1986	4.91	27.76	31	2011	6.85	2.54
10	1964	6.48	12.60	21	1987	13.33	-7.43	32	2012	8.13	13.05
11	1967	5.61	10.98	22	1988	3.86	15.08	33	2013	7.14	?

NEXT YEAR #UP-DN= 31-1 AVG%CHG=16.53 MED%CHG=15.01

The 2013 TOY of 7.14% also falls in the Goldilocks TOY range of 3-9%, whose VIP membership includes the entries listed below in ascending order of TOY.

One Year S&P Performance after 3-9% TOYs

#	YEAR	TOY%	NXTYR%	#	YEAR	TOY%	NXTYR%	#	YEAR	TOY%	NXTYR%	#	YEAR	TOY%	NXTYR%
1	1958	3.24	35.79	8	1959	4.66	2.86	15	1979	5.64	11.35	22	2013	7.14	?
2	1988	3.86	15.08	9	1986	4.91	27.76	16	1983	6.02	14.99	23	1951	7.55	13.53
3	1991	4.04	26.08	10	2010	5.05	11.45	17	1964	6.48	12.60	24	1989	7.67	18.21
4	1975	4.05	36.70	11	1985	5.05	21.66	18	1980	6.56	21.34	25	2012	8.13	13.05
5	1950	4.26	26.62	12	1954	5.25	36.14	19	1952	6.69	7.30	26	1999	8.53	16.39
6	1955	4.51	25.06	13	2009	5.40	33.63	20	2011	6.85	2.54	27	1963	8.96	17.46
7	1997	4.58	23.88	14	1967	5.61	10.98	21	1961	7.08	15.02				

NEXT YEAR # UP-DN = 26-0 AVG%CHG = 19.13 MED%CHG = 16.92

Bear Market Toys

I would not have likely stumbled across the TOY Barometer without the much appreciated prior published work of my esteemed predecessors in the area of seasonal indicators, but after nine months of sporadically reviewing its 62 year forecasting record, I have come to the conclusion that, indebted to the design specifications from hence it originated, TOY is the most accurate of indicators of the seasonal genre. Probably, attributable to the fact TOY's simplicity masked the utility of its message, it took me nearly a year to appreciate that few seasonal barometers exhibit TOY type forecasting accuracy on both sides of the ball. Below is the post 1949 TOY record for three different levels of TOY measures.

S&P One Year Performance vs TOY Measure

TOY Level	Interpretation	#Up-Dn	Pctup	Avg%chg	Med%chg
Greater than 3%	Bullish	31-1	96.88	16.53	15.01
0 – 3%	Neutral	11-7	61.11	5.86	5.75
Less than 0%	Bearish	4-9	30.77	-7.28	-7.93

Interestingly, there have been three 50% Bear Markets since 1950, ranging from 16 to 31 months. In no case, did a +3% Toy occur in the year preceding those three Bear markets, and negative TOYs appeared in advance of the turbulent second half conclusions of all three.

Toy Performance in 50% Bear Markets

Bear Market Time Frame	SP%Chg	First Yr TOY	2nd Yr TOY	3rd Yr TOY
01/11/1973 – 10/03/1974	-48.15	1973=2.85	1974=-5.11	N/A
03/24/2000 – 10/09/2002	-49.14	2000=2.38	2001=-1.84	2002=-2.04
11/19/2007 – 03/09/2009	-56.68	2007=2.09	2008=-7.54	N/A

Of present interest, since the bottom was put in place in March of 2009, we have had five (2009-2013) consecutive +3% TOYs, which is in stark contrast to the one +3% TOY (2004) experienced over the preceding nine years (2000-2008), which you may recall was not one of the grandeur periods of equity ownership.

The 2013 Tape Story

In February of 2010, my tape model titled "Planes, Trains and Automobiles (PTA)" was recognized by the Market Technicians Association (MTA) with the 2010 Charles Dow Award. I have since written ten subsequent versions of the PTA model, some of which replaced previous versions, but I continue to use components of versions 5, 10 and 11 in my daily market evaluation model. My favorite tape signal comes from a PTA11 S&P Price Thrust model which requires a couple of different price pattern setups, the details of which are proprietary at this time. I fancy this as my favorite model because:

1. **It provides stellar performance at each of the 1, 3, 6 and 12 month time frames.**
2. **It's only one year loss was the April 19, 2001 signal, arguably attributable to 9/11.**
3. **It is a Price Model and doesn't rely on Breadth, Up or Down Volume statistics whose 'daily' characteristics have undergone a makeover in the last 5-10 years.**

WAYNE'S PRICE THRUST SIGNALS

		FORWARD S&P % CHANGE				12 MONTH	
	DATE	1MT	3MTS	6MTS	12MTS	DRWDWN	DRWUP
1	19700529	-4.78	6.94	12.25	30.15	-6.95	36.86
2	19741011	5.64	2.07	18.33	23.99	-8.62	34.40
3	19750128	7.31	13.42	16.65	29.59	0.00	31.11
4	19800424	5.96	16.66	24.38	29.44	0.00	34.60
5	19820823	6.65	14.51	26.44	40.21	-0.64	47.29
6	19821007	10.37	12.76	17.83	32.61	0.00	32.76
7	19871030	-8.53	2.10	3.79	10.62	-11.07	12.66
8	19910118	11.09	16.93	15.99	26.08	-1.18	26.65
9	19980915	0.95	12.06	25.98	27.01	-7.54	36.73
10	19981016	7.52	17.69	24.86	18.08	0.00	34.30
11	19991029	3.29	-0.20	6.57	1.22	-2.43	12.07
12	20010419	3.05	-3.08	-14.37	-10.25	-22.96	4.72
13	20020731	0.49	-2.84	-6.13	8.63	-14.79	10.97
14	20021014	7.47	10.72	5.20	24.72	-4.84	24.72
15	20030317	3.57	17.25	18.91	30.25	-1.69	34.19
16	20081125	1.25	-10.79	3.45	29.53	-21.09	29.53
17	20090312	14.10	26.04	38.89	53.18	0.00	53.21
18	20090716	6.73	15.62	20.76	13.20	-0.04	29.40
19	20100708	4.80	8.87	18.80	25.56	-2.15	27.41
20	20100903	3.78	10.88	20.50	6.29	-1.15	23.46
21	20110815	0.38	4.43	11.52	16.69	-8.74	17.81
	#UP-DN =	19- 2	17- 4	19- 2	20- 1		
	AVG%CHG=	4.34	9.14	14.79	22.23		
	MED%CHG=	4.80	10.88	17.83	25.56		

The Drawdowns/ups are measured from the signal date, not peak to trough.

Unfortunately, this signal has not triggered in 15 months, and if it were all I had to rely upon, it would leave me with a neutral interpretation of the Tape's current message. I share the status of this signal with you to 1) put a sample of my incredible set of tools on exhibit and 2) put in context the significance of the Class B signal I am left to lean upon which, in my opinion, gives support to at least a non Bearish interpretation of the Tape Tea Leaves.

The January 2, 2013 Two Day Up Volume Thrust Signal

I define the two day Up Volume Thrust measure UDT2 as follows;
UDT2= 100.0* (UpVol)/(UpVol + DnVol), where Up Vol is the sum of the last 2 days S&P Up Volume

With the December 31 resolution of the Fiscal Cliff stage 1 issues, the S&P posted an impressive UDT2 of 95.92 on January 2. Below are the last 28 UDT2s above 89.2.

S&P PERFORMANCE AFTER AN S&P UDT2 > 89.2

#	DATE	UDT2	1MT	3MTS	6MTS	12MTS	DRWDN	DRWUP
			FORWARD S&P % CHANGE				12 MONTH	
#	DATE	UDT2	1MT	3MTS	6MTS	12MTS	DRWDN	DRWUP
1	19711129	90.69	9.42	14.09	18.47	24.74	0.00	25.54
2	19750102	90.70	9.61	17.37	34.10	29.43	-0.27	36.14
3	19750919	92.13	3.47	3.40	17.12	23.74	-3.44	23.74
4	19760105	90.49	8.44	11.81	12.45	13.16	0.00	16.47
5	19771111	90.39	-2.43	-6.15	1.27	-1.26	-9.46	11.47
6	19780414	91.30	5.54	5.02	12.63	9.77	-0.46	15.14
7	19791112	90.38	3.87	13.90	1.23	30.03	-5.11	29.17
8	19820823	94.07	6.65	14.51	26.44	40.21	-0.64	47.29
9	19821007	90.40	10.37	12.76	17.83	32.61	0.00	32.76
10	19840802	92.23	5.50	5.97	13.06	21.20	0.00	23.84
11	19870105	96.63	11.49	19.12	21.19	2.55	-11.21	33.54
12	19871030	91.97	-8.53	2.10	3.79	10.62	-11.07	12.66
13	19880601	95.54	1.91	-3.13	2.17	20.73	-3.64	20.73
14	19880729	92.69	-3.56	2.39	8.01	25.78	-5.53	25.78
15	19901112	89.42	3.35	14.40	17.61	24.18	-2.50	24.15
16	19960802	89.89	-1.58	6.23	18.67	42.97	-1.97	44.05
17	19970505	89.37	1.58	14.70	13.55	34.37	-1.77	36.10
18	20030218	90.18	1.80	10.94	17.45	35.32	-5.93	36.02
19	20090318	92.94	10.11	15.61	34.49	46.77	-3.25	46.81
20	20090821	91.56	3.75	6.36	8.09	4.44	-3.06	18.63
21	20100708	89.38	4.80	8.87	18.80	25.56	-2.15	27.41
22	20100902	95.30	5.15	12.06	20.03	7.69	0.00	25.09
23	20101202	91.70	2.96	7.11	7.48	1.86	-10.01	11.63
24	20110829	94.48	-4.11	-1.23	12.86	16.56	-9.16	17.27
25	20111005	90.96	9.55	11.98	22.21	27.70	0.00	28.12
26	20111103	90.22	-1.34	6.64	10.34	12.14	-8.13	16.22
27	20120727	90.16	1.77	1.87	6.08	7.22	-2.36	7.22
28	20130102	95.92	?	?	?	?		
		#UP-DN =	21-6	24- 3	27- 0	26- 1		
		AVG%CHG=	3.69	8.47	14.72	21.11		
		MED%CHG=	3.75	8.87	13.55	23.74		

Due in large part to its perfect six month forecasting record, an S&P UDT2 above 89.2 was once my favorite bullish tape signal. It has been dethroned by my price model due in large part to 1) concerns over the impact of various debatable influences on the characteristics of Breadth and the corresponding Up/Dn Volume measures, which have resulted in a plethora of 21st Century Lopsided Breadth and Volume days, and 2) the Price Thrust Model has a better record at the one and three month time periods. However, I feel this last signal UDT2 signal should not be completely disregarded because 1) the UDT2 of 95.9 far exceeds the previously established 42 year threshold of 89.2 and 2) My colleague, Mark Ungewitter discerned that this was the first occasion the NASDAQ and NYSE both simultaneously experienced back to back Lopsided Volume days since 1978. Given this UDT2 signal, plus a weaker active one on July 27, 2012 as well, I'm of an inclination to give the tape at least a 6 on a scale of 0-10, and I do not observe any tape evidence of a sufficient nature to reverse the guidance initially imparted upon us by this year's TOY Story.

2013 Election Cycle Analysis

It is a well documented phenomenon that equities, for politically motivated reasons, tend to perform better in the second half of the four year election cycle than in the first two years.

S&P Four Year Election Cycle Returns - Post 1929			
Election Year	Up-Dn Yrs	Avg%	Median%
1 Post (2013)	11-9	4.87	5.02
2 Midyear (2014)	12-9	4.51	1.06
3 Pre (2015)	18-3	13.44	17.27
4 Election (2016)	15-6	5.50	8.99

Below are the individual results for each of the last 20 Post Election or 'First Years' of the Election Cycle. The 5% average/median returns in the first year of the Election cycle are slightly below the average annual post-1929 S&P return of 7%.

Post Election Year Results							
1933	46.59	1953	-6.62	1973	-17.37	1993	7.06
1937	-38.59	1957	-14.31	1977	-11.50	1997	31.01
1941	-17.86	1961	23.13	1981	-9.73	2001	-13.05
1945	30.72	1965	9.06	1985	26.33	2005	2.98
1949	10.26	1969	-11.36	1989	27.25	2009	23.45
# UP–DN = 11-9 AVG%CHG = 4.87% MED%CHG = 5.02%							

However, the Bulls can take some refuge in the fact that in 7 of those 11 postelection years in which the economy was of a sufficient condition to allow the incumbent party to maintain control of the White House, the S&P posted a positive return and the last four times Democrats held serve, the S&P was positive for an average annual four case return of 20.3%.

S&P Post Election Year Performance When Incumbent Maintains Office					
1937D	-38.59	1957R	-14.31	1989R	27.25
1941D	-17.86	1965D	9.06	1997D	31.01
1945D	30.72	1973R	-17.37	2005R	2.98
1949D	10.26	1985R	26.33	2013D	?
#UP-DN = 7-4 AVG%CHG = 4.50 MED%CHG = 9.06					

And although, it is the general perception that Republicans are more business friendly than Democrats, post 1929 equity prices have prospered better under Democratic White Houses.

S&P Annual Performance vs Presidential Party				
PARTY	#UP-DN	%UP	AVG%	MED%
DEMOCRATIC	31-13	70.5	10.30	12.61
REPUBLICAN	25-14	64.1	3.51	3.53

I will not attempt to make the case the election cycle setup is in itself overwhelmingly bullish for equities, but I believe I have provided evidence, the election cycle variables are not substantively bearish enough to overrule the positive spin provided in the 2013 TOY Story.

2013 Interest Rate Considerations

The Fed Funds rate has been at room temperature for so long that most of the traditional equity vs interest rate models have been out of play for sometime, which is probably a moot point because one of the lessons from the 2000-2002 and 2008 Bear Markets is most of the interest rate trading rules designed using data from the 1960 – 2000 high interest rate, inflationary period no longer apply. For most of the last half of the 20th Century, the equity vs interest rate rule was fairly simply; If rates were in an uptrend, be underinvested in equities and if rates were in a down trend, be overinvested in equities. And most of my research in this area, suggest these are still rules to adhere to if rates are 6% or higher. Unfortunately for the majority of interest rate setup systems, we are not in Kansas anymore.

My models currently measure interest rates at 4 standard deviations below the historic norm and trending sideways to modestly upward. My analysis of interest rate/equity market correlations suggest higher rates from extremely low levels are generally somewhat conducive to higher equity prices as fears of the potential deflation, which originally induced the extremely low rates begins to dissipate. Dating back to my 2012 Outlook comments, I have been on record that if the 30 year bond yield (3.03%) could make its way back to 3.5%, the S&P would likely accompany it to record highs. If you dig deep enough into the pre double digit inflation period of the 20th century, there are studies which support this idea.

For example, in 1965, one of that generations most respected market technicians, Edison Gould, published his 'Three Steps and a Stumble' rule in Barron's which suggested, it took three hikes by the Federal Reserve to put a nail in the Bull's coffin. It is very important to note, it is not a 'one step' and a stumble rule, which is because the first hike is not bearish. In fact, the first sequence of rate hikes is usually bullish, as it suggests the economy is now starting to grow and interest rates are likely still not competition to the earnings yields which equities promise. My instincts, derived from all sources available, are that the lower rates are when the hiking phase is initiated, the more increases it will take to impede the trailing Bull's advance. From a bullish perspective, I am much more worried about rates going back to 2.5% than I am about them going to 4% in the next 12 months, as equities offer one of the better havens against the threat of inflation at this point in time.

2013 S&P Forecast

I am not a fan of making long range forecast, as I fancy myself more of a trader than a market prognosticator and fear one loses some much needed flexibility when one paints himself into a corner with verbose predictions. All trader/market timer types are wrong frequently, but most of those who have stayed in the black for multiple decades, usually do so by not making a habit of staying wrong for very long. I am much more comfortable simply following the Tea Leaves each day and turning left or right as the impending market road signs dictate. For example, the Bullish TOY would get additional confirmation from a 4% January, which has led to 17-1 February-Decembers, If February post a gain, we know the S&P is 19-0 over the following 12 months when December, January and February are all each positive. A bullish tape signal during a First Quarter advance would aid the bullish cause, but if the advance is ugly and interest rates head south of recession city, an attractive short might present itself as we enter the 'Sell in May and Go Away' Zone. It is much the more trader practical to take it a day at a time. But I must end this diatribe, as the end of the page approaches. If my life depended on it, I'd bet on a yearend S&P finish in the vicinity of 1650.