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Seasonality, Sequestration, and Syria: What's Driving Stocks Now?

In a year that has been mostly smooth sailing for stocks, August headwinds knocked the S&P 500 off course.

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The "500" registered a 3.1% price decline for the month, while all 10 of the index's sectors as well as 86% of its 132 subindustries sustained losses.[1] The August sell-off may be attributed to a number of factors, including seasonality, sequestration, and Syria -- and the subsequent policy uncertainty coming from the Federal Reserve, the State Department, and Congress.

September historically has been the worst performing month for stocks. It is also the only month in which the S&P 500 has declined more frequently than it has risen. Yet much of the current market angst hangs on what the Federal Reserve will do at its September 19 meeting. With the still-fragile labor market, analysts at S&P think it is unlikely that the Fed will begin tapering its bond buying policy this month, as some had previously anticipated. In addition, if the jobs numbers soften further, it is expected that the Fed will wait until 2014 to take action.[2]

Add to the current equation the likelihood that Congress will not act soon to end sequestration, which is the fiscal policy process of automatically reducing the federal budget across most departments and agencies. There are also few signs that lawmakers will hammer out a solution before the continuing resolution and debt ceiling events play out. Given these variables, 2013 will likely be another year of subpar growth -- just 1.7%, by S&P's forecast, and the stock market is likely to remain volatile until a sustainable economic recovery is evident.[2]

Shocks & Stocks: The Syria Factor

Another issue weighing on the global financial markets is how the United States will attempt to solve the Syrian situation. Specifically, what will be the magnitude of market fallout from the expected retribution of Syria for its use of chemical weapons? Even though the rebellion in Syria started more than two years ago -- and many are willing to quickly dismiss the fallout from a targeted U.S. strike -- the response by Syria's neighbors, as well as China and Russia, pose increased uncertainty.[1]

The U.S. stock markets have weathered a variety of unanticipated shocks over the past 70 years, including wars and near wars, assassinations and attempts, terrorist attacks, and financial collapses. And while the initial shock sent the S&P 500 down a median of nearly 2.5% during the subsequent trading day, the bottom was reached in only six days and the "500" recouped all that was lost in just 14 days.[1]

Granted, even though selected events took much longer to play out than the medians would suggest, these extreme situations usually occurred within the confines of a long-term bear market and did not precipitate the initial decline.[1] Examples of these include:

- Pearl Harbor.
- President Nixon's resignation.
- The terrorist attacks on 9/11.
- The collapse of Lehman Brothers.

So should history repeat itself, and there is no guarantee it will, unanticipated events that occur within bull markets that throw markets for a loop are typically assessed for their economic impact in short order.[1]

What's more, a majority of prior market shocks have proven to represent buying opportunities more than reasons to sell. "While we believe the equity markets will remain choppy in the near-term," stated S&P Capital IQ Chief Equity Strategist Sam Stovall, "we would be more concerned over a sharp decline in global economic growth projections and a resulting slowing of EPS growth expectations, neither of which we forecast in the coming quarters."[1]

[1]Source: S&P Capital IQ, *Global Equity Research*, "Shocks & Stocks," September 3, 2013.

[2]Source: S&P Capital IQ, *U.S. Investment Policy Committee Notes*, August 28, 2013.