



WEEKLY MARKET COMMENTARY

Update on Risks and Opportunities in the Financial Markets

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Weekly Market Commentary | Week of September 3, 2013



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Highlights

The historical pattern for the stock market around military actions points to a pre-strike rally recouping earlier losses. However, the current pullback has more to do with domestic economic and policy concerns than with foreign policy.

Stocks Likely to Focus on Domestic Over Foreign Policy in September

The markets were most focused on an impending military strike on Syria last week. While prospects for an imminent strike have faded, the likelihood of military action in the near future remains. Unfortunately, the past offers us many periods of military action. Looking back at these can help us draw parallels and gain perspective on the most likely outcome for the markets.

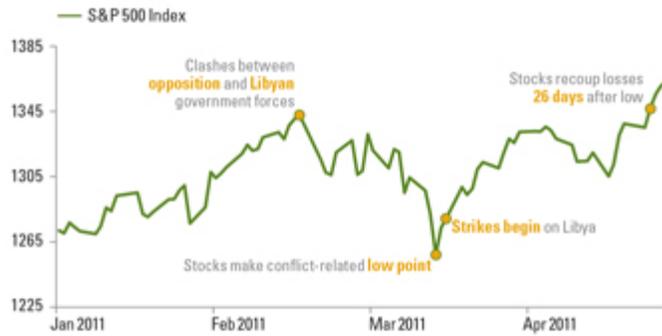
Although the circumstances surrounding prior conflicts have been varied, investors have experienced the same emotional response and, as a result, the markets yielded a similar outcome. Most military conflicts have prompted a common pattern in the stock market: impending war acted as a negative from when the United States committed to action until action began; once action began, markets rebounded. The rebound can come quickly, as it did in WWII when Doolittle's raid in April 1942 retaliating for the December 1941 Pearl Harbor attack turned stocks higher despite a war that lingered for years. The buildup to the Korean War caused a sharp market drop in mid-1950, but losses were quickly reversed as soon as U.S. troops were engaged.

In recent decades, the pattern changed slightly, with the stock market bottoming and starting to recover ahead of the military strike [Figure 1]. Examples include:

- Stocks bottomed on January 9, 1991, just days ahead of the January 17, 1991 start of the Gulf War. The related 6% decline that began in mid-December 1990 was fully recouped in the following six trading days.
- Stocks bottomed on December 14, 1998, just days ahead of the December 16, 1998 bombing of Iraq. The related 4% decline that began in late November 1998 was fully recouped in the following four days.
- Stocks bottomed on March 23, 1999, just days ahead of the March 24, 1999 strikes on Serbia. The related 4% decline that began a few days earlier in mid-March was fully recouped in the following nine days.
- Stocks bottomed on March 11, 2003, just days ahead of the March 19, 2003 strike and subsequent invasion of Iraq. The related 13% decline that began in mid-January was fully recouped in the following 38 days.
- Stocks bottomed on March 16, 2011, just days ahead of the March 19, 2011 strike on Libya. The related 6% decline that began in mid-February was fully recouped in the following 26 days [Figure 2].

1 Pre-Strike Stock Market Rallies

Conflict	Related Decline	S&P 500 Bottomed	Start of Military Action	Days to Recoup Losses
Gulf War	6%	Jan 9, 1991	Jan 17, 1991	6
Iraq bombing	4%	Dec 14, 1998	Dec 16, 1998	4
Serbia strikes	4%	Mar 23, 1999	Mar 24, 1999	9
Iraq War	13%	Mar 11, 2003	Mar 19, 2003	38
Libya strikes	6%	Mar 16, 2011	Mar 19, 2011	26



Source: LPL Financial, Bloomberg data 09/03/13

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The historical pattern suggests that if a strike on Syria begins soon, then the S&P 500 may have bottomed last week after a 4.6% pullback from its peak on August 2, 2013. However, this stock market pullback began well before the August 21, 2013 chemical attack and has more to do with domestic economic and policy concerns than with foreign policy.

Instead, the outlook for economic and profit growth, along with the potential for volatility related to the Federal Reserve (Fed) tapering its bond-buying program and the fiscal fights in Washington, are likely to again take precedence in the minds of investors. This week's economic reports, including the widely watched Institute for Supply Management (ISM) manufacturing report on September 3 and the employment report on September 6, provide important data points on the Fed's decision whether to begin tapering this month. On the fiscal front, the continuing resolution funding the federal government runs out at the end of this month, and the debt ceiling is likely to be hit in mid-October with Congress jointly scheduled to be in session only nine days in September. The combination of factors may contribute to another volatile month for investors in the stock market.

It can be a challenge for investors to remain disciplined in an environment of economic uncertainty and military conflict, especially after the long trek back to even for many investors after the steep losses suffered in the financial crisis of five years ago. We do not think this is a time to sell or that investors need to fear a major stock market decline. Instead, we continue to believe investors should expect these 5-10% pullbacks more frequently as part of a return to normal market volatility as the four-and-a-half year old bull market matures-but continues.

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Stock investing involves risk including loss of principal.

INDEX DESCRIPTIONS

The Standard & Poor's 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The Institute for Supply Management (ISM) index is based on surveys of more than 300 manufacturing firms by the Institute of Supply Management. The ISM Manufacturing Index monitors employment, production inventories, new orders, and supplier deliveries. A composite diffusion index is created that monitors conditions in national manufacturing based on the data from these surveys.

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