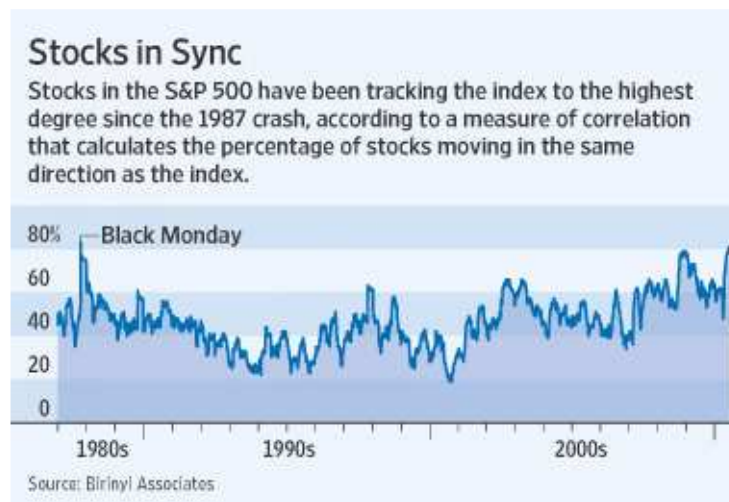


Tuesday, July 13, 2010

Indexing and Futures Take Over - Component Stocks' Correlation to S&P 500 at Highest Level Since '87 Crash

The Wall Street Journal notes that stocks are trading in lock-step more than at any time since the 1987 crash. Please consider [The Herd Instinct Takes Over](#).

In recent weeks, stocks in the Standard & Poor's 500-stock index have shown an increasing tendency to move in the same direction at the same time. Last week, those stocks' tendency to move in the same direction as the index hit an extreme not seen since October 1987, according to research by investment group Birinyi Associates in Westport, Conn.



The average correlation since 1980 has been 44%. But by mid-June, the correlation had jumped back above 70%, as investors stopped looking for winners and just sold broadly. Last week it surpassed its 2008 high of 79% and hit 81%, the highest level since the 1987 crash, when it touched 83% for one day. That means that on most days recently, the great majority of stocks in the S&P 500 were moving in the same direction, up or down.

Correlation typically goes up during volatile periods, reflecting investors' tendency to dump stocks wholesale rather than try to pick out stocks that once were viewed as refuges, such as those that pay dividends.

Volume has been anemic during this rise, with little individual participation. So did "herding" take over or did black-box futures and flash-trading take over?

I do not consider this a good omen for equities.

Mike "Mish" Shedlock

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