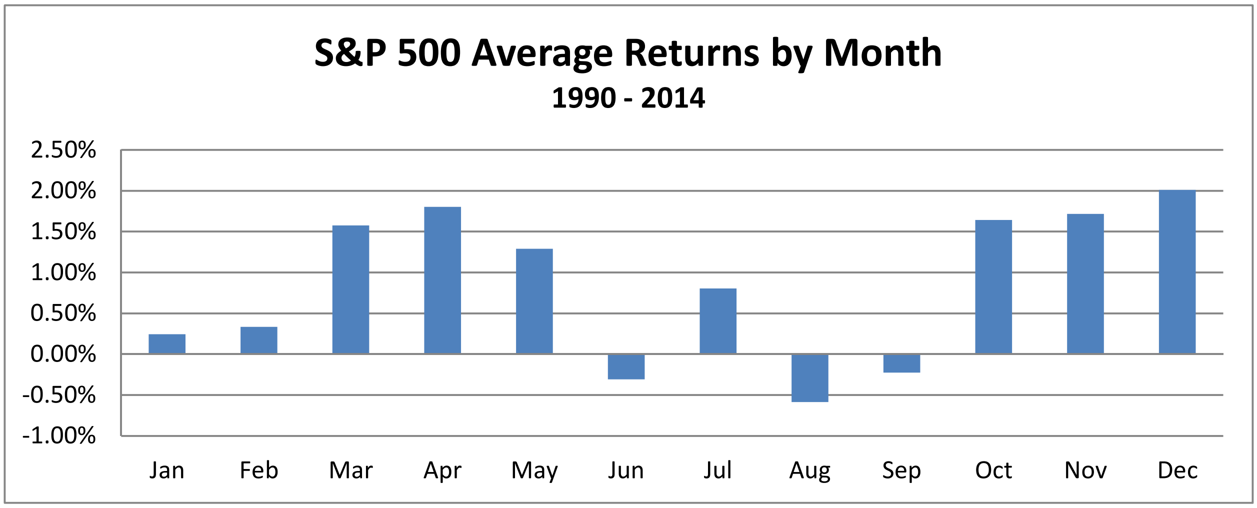
December 14, 2015
'Tis the Season

As we write this the S&P 500 with dividends is down 0.4% for the year and more than three percent in December. A down December is unusual based on historical returns going back to 1930. Indeed, they averaged 1.7% since 1930, 1.7% since 1960 and 2.0% since 1990. There have been down Decembers four times since 1990, the worst being in 2002, when the S&P 500 declined 5.9%.

The chart below summarizes monthly seasonality going back to 1990. What does it tell us?



First, as discussed above, December does look like a good month. Second, we can see why many practitioners suggest "Sell in May and go away." The June through September period is clearly weak. We monitor "Sell in May" but it is not currently in our model because the effect has dissipated. Indeed, from 2000 through 2014 the June-to-September period was down 1.4%, but in more recent years, from 2005 through 2014, those months were *up* 1.6% on average.

What about the January effect? Tax loss selling was said to send poorly performing stocks lower at the end of December after which a bounce would occur in January. But the January effect has pretty much disappeared, perhaps because individual investors get their equity exposure by owning mutual funds rather than individual stocks. Moreover, many mutual funds shifted fiscal years away from December, leaving less tax loss selling in that month.

So how do we think about seasonality? Are we willing to bet on it? Yes, but the bets are very small. One effect that is currently among our short term models is called "turn of the month." There is literature indicating that returns tend to be higher at the beginning of each month in part because of new money invested in retirement accounts and other regular money flows like loan payments.

What about the rest of this year? Many are looking for a Santa Claus rally to begin this week. Given that December tends to be a strong month, it might be a good bet. But for the typical investor these so-called market anomalies are tough to exploit. Here's why. First, extensive resources are required to monitor the anomalies. They go in and out of favor over time. Second, figuring out how much to bet on each anomaly is not trivial. Finally, it takes substantial capital to make the required large, medium and small bets simultaneously.