January

The January effect

Ever since economist Sidney Wachtel first coined the term in 1942, analysts and market pundits have been eager to talk about a seasonal market movement known as “the January effect.”

In its simplest form, the January effect is the rise in stock prices over the first two weeks of each year. The rise is said to be more significant in small-cap stocks, which will eventually fall behind the gains of large-cap stocks over the remainder of the year. Additionally, the price growth supposedly sets the tone for the rest of the year — a strong January effect means a positive year is coming, while a loss in early January means a bad year.

Though there are logical explanations and repeated documentation of the effect, many individuals refute its reliability and question whether it exists at all.

Sound superstitious? There are some reasons why the January effect makes sense. The growth is largely a recovery from a supposed market drop in the last weeks of December, when investors (both private and institutional) sell off weak stocks to get them off their books and lock in losses for tax purposes. Investors then repurchase the same shares at the start of the year, causing the January effect.

Some behavioral investors believe that psychology also helps boost the January effect, as people tend to be the most optimistic during the first part of the year. For investors, this may mean putting more money into investments or taking a risk on a cheap stock that will hopefully make huge returns.

Changing tax rates are another reason the January effect is said to occur. When the government announces a raise on the capital gains tax in the upcoming year, investors are encouraged to sell their profitable investments before the end of the year to take advantage of the current tax rate. This causes December prices to fall across the board and then rise to a normal level in January.

Is the January effect real?

Historically, stocks have often risen during the first two weeks of January, and 25 out of the past 40 years have seen the S&P 500 end the month ahead of where it started on January 1. Over the total year, however, the S&P has increased for 30 of those 40 years. The truth is that the stock market, regardless of its performance on a short timeline, has historically always trended upward on a longer timeline of several years.

One of the reasons many say that the January effect cannot be real is that the market would be aware of it. The “effect” is over 70 years old, so investors have had more than enough time to learn how to compensate and, therefore, negate its influence.

Even if stock rebounds were consistent, selling assets for just a week and then repurchasing them is a foolish practice for any long-term investor. Not only could share prices increase in that time but the investor is also guaranteed to spend some money on the sale and repurchase transactions.

It is possible that the January effect provided observant investors a chance to game the market in the years before 1942; however, now that the market is more efficient and much more analyzed, seasonal “sure bets” simply do not exist. Even in the case of raising taxes, eager investors are as likely to cause the January effect in October as they are to cause it in December and January.

The best thing investors can do with the January effect is ignore it. Markets are volatile and short-term fluctuations should not affect an investor’s decision to buy or sell. An investment strategy relies on the appreciation of a successful company’s assets, not on the speculation of market moods from one month to the next.

The market at a glance

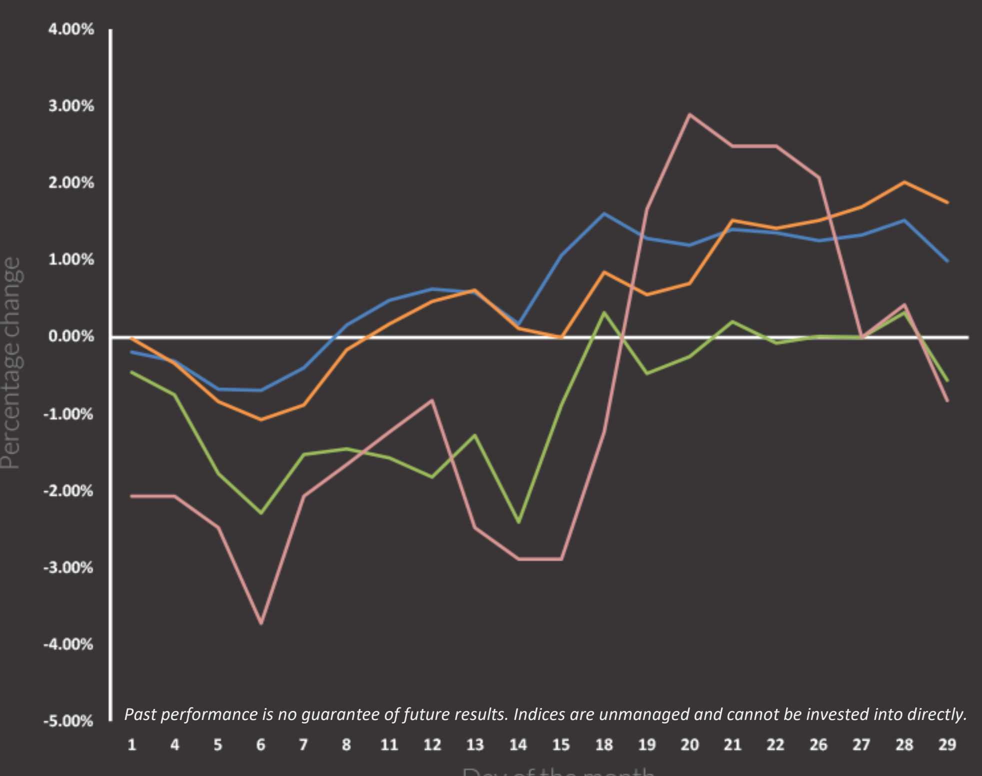
December

U.S. Large Cap
(S&P 500)
2,673.61 (0.98%) ▲

U.S. Mid/Small
(Russell 2000)
1,535.51 (-0.56%) ▼

International Large
(NYSE International 100)
5,792.03 (1.74%) ▲

U.S. Treasuries
(U.S. 10-year Treasury yield rate)
2.40 (-0.83%) ▼



The market in action

- The government passed legislation that represented the most significant overhaul to the tax system in decades. The "Tax Cuts and Jobs Act" will alter main tenets of the tax code, including: lowering the corporate tax rate, raising the standard deduction, adjusting individual tax brackets, and more.
- The past 12 months saw major stock indices experience massive increases in value, led by notable indices such as the Dow Jones Industrial Average (25 percent), the S&P 500 (19 percent), and the Nasdaq (28 percent).
- In the final months of 2017, bitcoin became one of the most frequently discussed topics in the world of finance and economics. At its peak, bitcoin increased in value by over 1,900 percent since the start of the year. Ultimately, bitcoin ended the year valued at about $13,860, roughly 1,261 percent higher than its value at the beginning of 2017.
- The Walt Disney Co. bought the majority of 21st Century Fox. The deal, which was announced in mid-December, is reportedly worth over $52 billion.
- According to a recent study by NerdWallet, the average household in the US owes nearly $16,000 in credit card debt.
- In a recent report by the Wall Street Journal, about 5 million Americans are currently in default on student loans — roughly double the amount from four years prior. This represents nearly 13 percent of all outstanding student loans.
- Existing home sales in November hit an 11-year high. Sales increased by about 5.6 percent from the previous month. Some analysists believe that this information points to a recovering housing market that has been slow to regain its value following the Great Recession.

A Healthy Year Ahead?

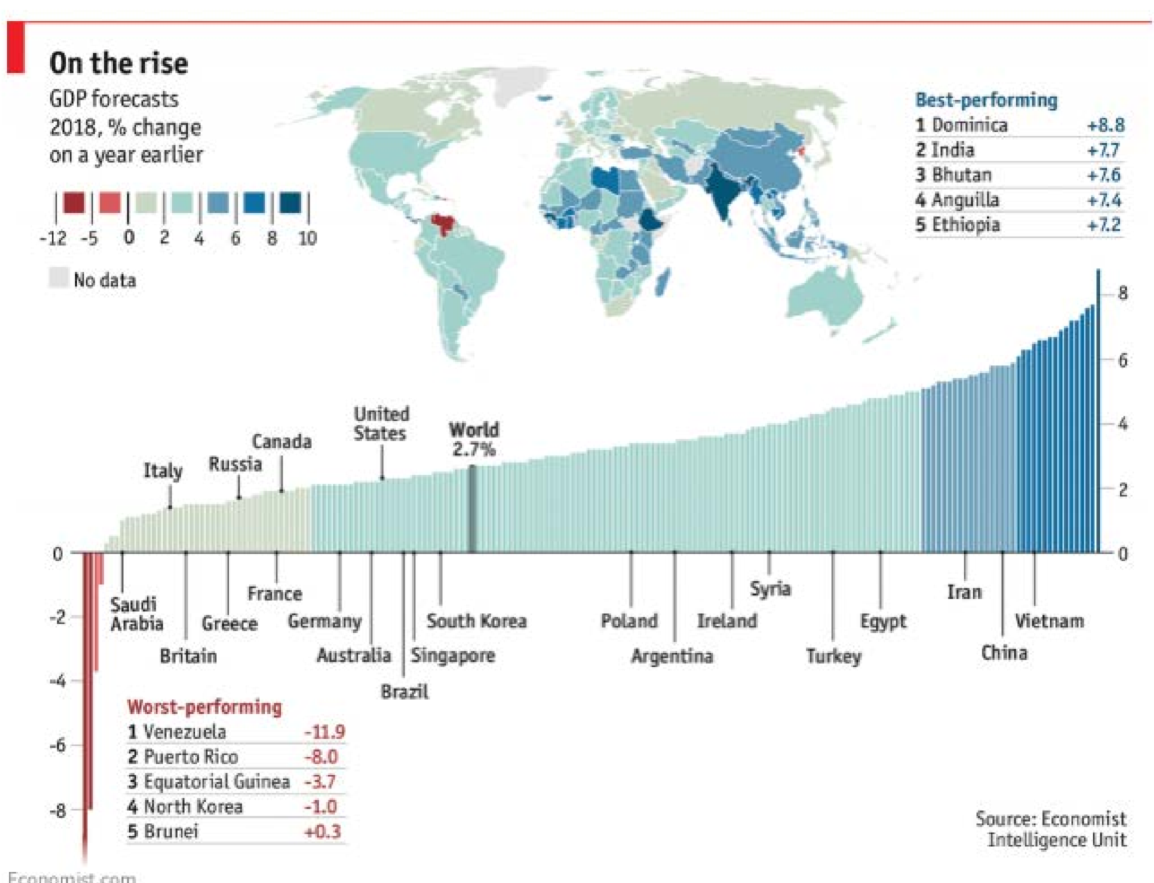
According to professional forecasters around the world, the global economic landscape is healthy going into 2018—so much so that only three countries and one territory are expected to experience a downturn in their gross domestic product over the coming 12 months. The map and chart show which countries are growing fastest (light, dark and darker blue), and which are lagging the rest of the world (light green and red). The laggards include Venezuela (projected to lose 11.9% of production in the next 12 months); the hurricane-ravaged territory of Puerto Rico (-8.0%); Equatorial Guinea (-3.7%); and North Korea (-1.0%).

At the other end of the scale, Dominica (+8.8%), India (+7.7%), Bhutan (+7.6%), Anguilla (+7.4%) and Ethiopia (+7.2%) are expected to experience the fastest growth.

By the largely blue and green color of the global map, you can see what a healthy economic world looks like—a nice contrast to the chain of collapse that we experienced in the Great Recession after years of Wall Street speculation came home to roost. If you're rooting for the U.S. to win this race, however, you could be disappointed; the projections for American economic growth come in well behind the global average of 2.7%.

-Bob Veres

Source: https://www.economist.com/blogs/graphicdetail/2018/01/daily-chart-3?fsrc=scn/tw/te/bl/ed/



Meritas Advisors, LLC
info@meritasadvisors.com
meritasadvisors.com

4040 Civic Center Dr., Suite 200
San Rafael, CA 94903
415-690-8547

Meritas Advisors, LLC is a Registered Investment Advisor with the State of California Department of Business Oversight. This newsletter is provided for educational purposes only, does not constitute a complete description of our investment services, and is not intended to provide specific investment, tax or legal advice or recommendations. Meritas Advisors does not provide tax or legal advice. The views expressed represent the opinions of the author and not necessarily those of Meritas Advisors, LLC and are subject to change without notice. The information contained herein is based on information we consider to be reliable, however, accuracy is not guaranteed. Past performance is not an indicator of future results.