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Market Seasonality

Truth or Myth???

There are several catch phrases in the financial industry that are used to give advice on how one should invest their portfolio. There's the *January Effect*. Another of my favorites is *Sell in May and Go Away*. And a more recent phrase, *June Gloom*. What do these phrases mean and more importantly, are they good advice on how to manage risk in your portfolio?

The January Effect

The concept or ideology of the *January Effect* is, as January goes, so does the rest of the year. It's basically saying that the momentum of January is felt throughout the year. But should January really predict how well the markets perform in February through December? Is this a concept that you can use to manage your portfolio? If you look at it just on the surface, it appears to be very correlated. Since 1950, when January has been up, February through December has averaged 11.89%. If January was down, February through December has averaged 1.74%. Conceptually, one could sit on the sidelines, watch what happened in January, and if it was positive, invest for the rest of the year or sit out if it was negative. But does this really work? Let's dig into the concept a little deeper.

First, let's look at how accurate the *January Effect* has been since 1950. The S&P 500 has had 43 positive Januarys since 1950. When January was positive, February through December were positive 86% of the time. Pretty accurate. There were 28 times that the S&P 500 had a negative January during this same time period. Only 11 times was that reading correct, meaning February through December were also negative. While the *January Effect* was accurate almost 70% of the time, it wasn't helpful at all when January was negative. In fact, the *January Effect* has only been 47% accurate since the year 2000.

	January	Feb - Dec
2000	-5.09%	-5.32%
2001	3.46%	-15.95%
2002	-1.56%	-22.15%
2003	-2.74%	29.94%
2004	1.73%	7.14%
2005	-2.53%	5.67%
2006	2.55%	10.80%
2007	1.41%	2.09%
2008	-6.12%	-34.48%
2009	-8.57%	35.02%
2010	-3.70%	17.11%
2011	2.26%	-2.22%
2012	4.36%	8.67%
2013	5.04%	23.38%
2014	-3.56%	15.50%
2015	-3.10%	2.45%
2016	-5.07%	15.39%
2017	1.79%	17.32%
2018	5.62%	-11.22%
2019	7.87%	19.48%
2020	-0.16%	16.45%

Source: Ned Davis Research

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We also look to see if the concept of the *January Effect* helped investors make money. In order to act upon the *January Effect,* an investor needs to see if the S&P 500 had a positive or negative first month. In other words, an investor would sit on the sidelines during January waiting to see if January was positive or negative. If it was positive, our investor would invest the next eleven months. If it was negative, our investor would sit out the rest of the year. Had our investor put $100,000 towards this ideology in 1950, they would have grown their portfolio to almost $9.9 million. Sounds impressive, right? Had the same investor just invested in the S&P 500 and remained invested the whole time, they'd have over $22 million. Investing based upon the *January Effect* cut this investor's performance by more than 50% and cost this investor over $12 million in opportunity costs. Not a great way to accumulate wealth.

I ran the same strategy to see if it was working in more recent years. As you can see from the chart below, the *January Effect* is not adding value to an investor's portfolio.

	January	Feb - Dec	Out if Jan is Negative	Fully Invested
2000	-5.09%	-5.32%	$ 1,000,000.00	$ 898,607.88
2001	3.46%	-15.95%	$ 840,500.00	$ 781,412.61
2002	-1.56%	-22.15%	$ 840,500.00	$ 598,839.77
2003	-2.74%	29.94%	$ 840,500.00	$ 756,811.57
2004	1.73%	7.14%	$ 900,511.70	$ 824,875.59
2005	-2.53%	5.67%	$ 900,511.70	$ 849,593.39
2006	2.55%	10.80%	$ 997,766.96	$ 965,353.89
2007	1.41%	2.09%	$ 1,018,620.29	$ 999,425.75
2008	-6.12%	-34.48%	$ 1,018,620.29	$ 614,748.54
2009	-8.57%	35.02%	$ 1,018,620.29	$ 758,899.61
2010	-3.70%	17.11%	$ 1,018,620.29	$ 855,863.68
2011	2.26%	-2.22%	$ 996,006.92	$ 855,776.62
2012	4.36%	8.67%	$ 1,082,360.72	$ 970,519.25
2013	5.04%	23.38%	$ 1,335,416.66	$ 1,257,776.96
2014	-3.56%	15.50%	$ 1,335,416.66	$ 1,401,015.11
2015	-3.10%	2.45%	$ 1,335,416.66	$ 1,390,844.45
2016	-5.07%	15.39%	$ 1,335,416.66	$ 1,523,527.21
2017	1.79%	17.32%	$ 1,566,710.83	$ 1,819,396.62
2018	5.62%	-11.22%	$ 1,390,925.87	$ 1,706,037.95
2019	7.87%	19.48%	$ 1,661,878.23	$ 2,198,794.19
2020	-0.16%	16.45%	$ 1,661,878.23	$ 2,556,399.04

Source: Ned Davis Research

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Sell in May and Go Away!

The concept of *Sell in May and Go Away* is to avoid the weaker times in the market. There are a couple of different versions of this concept, varying only in when the investor gets back into the market. In the first version, the investor goes to cash on May 1st of every year and then buys back on October 1st. In the second version, which has slightly worse performance, the investor buys back into the market on November 1st. Some investors have shied away from investing in October, because it is seasonally the weakest month of the year. There have been enough good Octobers that the performance is better getting back into the markets that month.

In this case study, we have one investor with two IRA accounts; thus we don't have to take taxes into consideration for this concept. Each account has $10,000 starting in 1950. Account #1 is invested in the S&P 500 from May 1st through September 30th. Account #2 is invested from October 1st through April 30th. According to Ned Davis Research, Account #1 grows from $10,000 to $15,367. Account #2, the one invested October through April, grows from $10,000 to $1,505,736 — a staggering difference.

While these are staggering numbers, the problem is that no investor would be able to really apply this in real life. *Sell in May and Go Away* hasn't added consistent value since the dot-com bubble burst. See the chart below. Staying fully invested outperformed being invested only from October through April.

Let's look at the psychology of trying to implement this strategy. Imagine putting this strategy to work in 2003. You would miss out on five straight May thru September time periods that were positive, costing you almost 20% in returns. Perhaps then, you decide to give up on the strategy in 2008. You take a big hit, losing 15% by investing during the May to September time period. You decide you'll never invest again during the May to September time period, only to miss a 21% recovery in 2009.

Sell in May and Go Away has truth to the concept. There have historically been better times of the year to invest. The reality is, investors go on vacation during the summer months. This means that there will be less trading. This is often referred to as the *Hampton Effect*. The problem with investing based upon this concept is, there are far too many good May through September time periods where value could be added to your portfolio that one can't invest in this kind of manner.

	May - Sept	Oct - Apr	Year Round	Only Oct - Apr
2003	8.62%	11.18%	$ 1,207,637.16	$ 1,111,800.00
2004	0.66%	7.90%	$ 1,311,640.56	$ 1,199,632.20
2005	6.22%	6.66%	$ 1,486,013.36	$ 1,279,527.70
2006	1.93%	10.97%	$ 1,680,855.29	$ 1,419,891.89
2007	2.99%	-9.25%	$ 1,570,984.92	$ 1,288,551.89
2008	-15.82%	-25.17%	$ 989,593.16	$ 964,223.38
2009	21.11%	12.26%	$ 1,345,431.92	$ 1,082,437.17
2010	-3.83%	19.49%	$ 1,546,083.35	$ 1,293,404.17
2011	-17.03%	23.55%	$ 1,584,881.31	$ 1,598,000.86
2012	3.06%	10.89%	$ 1,811,253.61	$ 1,772,023.15
2013	5.26%	12.04%	$ 2,136,071.23	$ 1,985,374.74
2014	4.69%	5.74%	$ 2,364,613.89	$ 2,099,335.25
2015	-7.93%	7.57%	$ 2,341,906.48	$ 2,258,254.92
2016	4.99%	9.96%	$ 2,703,660.87	$ 2,483,177.11
2017	5.67%	5.11%	$ 3,002,949.01	$ 2,610,067.46
2018	10.04%	1.09%	$ 3,340,463.55	$ 2,638,517.20
2019	1.05%	-2.16%	$ 3,302,626.78	$ 2,581,525.23
2020	15.47%	24.33%	$ 4,741,378.20	$ 3,209,610.32

Source: Ned Davis Research

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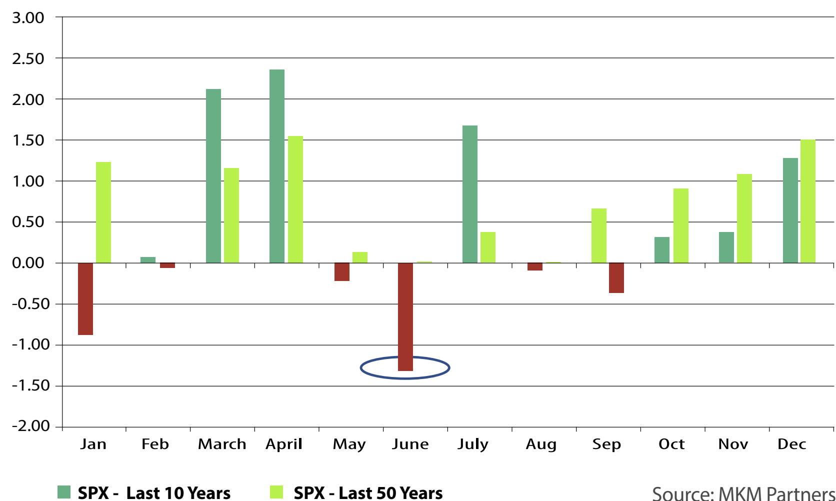
June Gloom

The term *June Gloom* comes from the fog that often thickly collects on the west coast beginning during the month of June, and normally remains a daily occurrence through much of the summer months. As you can imagine, west coast investors began to tie their grey, cool mornings with the summer slowdown we just discussed regarding the concept of *Sell in May and Go Away.*

As you can see from the adjacent chart, June has been a very weak month to invest. In fact, it is the worst performing month over the past decade.

S&P 500 Average Monthly Performance



Source: MKM Partners

S&P 500 Monthly Average

	Since 1900		Since 1952		Since 1982	
	Mean	Rank	Mean	Rank	Mean	Rank
JAN	1.59%	1	1.37%	1	1.19%	5
FEB	0.34%	7	0.64%	7	0.98%	6
MAR	0.28%	9	0.57%	8	0.42%	9
APR	0.80%	3	1.24%	3	1.41%	1
MAY	0.31%	8	0.69%	6	1.22%	4
JUN	**0.23%**	**10**	**0.36%**	**9**	**0.71%**	**7**
JUL	1.07%	2	0.72%	5	0.59%	8
AUG	0.79%	4	0.15%	10	0.22%	10
SEP	0.11%	11	-0.08%	11	0.15%	11
OCT	-0.25%	12	-0.08%	12	-0.12%	12
NOV	0.50%	6	1.29%	2	1.40%	2
DEC	0.66%	5	1.24%	4	1.36%	3

Source: Ned Davis Research

But is that a clear understanding of June's performance, or any month of the year for that matter? I love the phrase, "Lies, damn lies, and statistics." If we slightly change the time period in which we sample, the appearance changes completely. In the chart to the left, you see that while June hasn't been a great month, it hasn't been bad either.

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Conclusion

Investors often look for an easy way to explain a situation, or they are looking for an easier way to invest their portfolio. The closest we can come to a useful tool for explaining seasonality of investing is *Sell in May and Go Away*. But even this concept doesn't consistently add value, and might even make investors more irrational with changes if they saw the markets moving up while they were sitting on the sidelines.

Portfolio management requires year-round diligence and care. It requires discipline and clinical decision-making to add value. As we've said so often, no investment ideology will work in all markets. There is no simplified way to make money in the markets. While investors might look to seasonality to help explain why the markets are performing in a specific way, in most cases, these investors are looking for patterns where there are none. They are trying to simplify the complex.

Polaris Wealth will be holding our quarterly webinar on July 14th at 12pm Pacific Time. Please join us to review what has already occurred during the first half of the year, and what we see happening during the second half of 2021.

If you have additional questions, please reach out to your financial advisor for a review. As always, I am happy to answer any questions or comments that may still be lingering. Please feel free to reach out to me too.

As always, I welcome your comments and questions.

Sincerely,

Jeffrey J. Powell

Managing Partner & Chief Investment Officer

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