PRATO CAPITAL

DO YOU BELIEVE IN THE SANTA CLAUS....RALLY?

DECEMBER 2018

A Santa Claus Rally?

Since it is December, it is a great time to talk about Santa Claus. Of course, at Prato Capital Management, we would like to talk about the often mentioned "Santa Claus Rally" in the stock market.

There are many in the financial media that talk about a "Santa Claus Rally". It is often spoken of but not as frequently defined. Some analysts often refer to any stock market rise after Thanksgiving as a Santa Claus Rally. There is only one definition that does hold some statistical basis for a rally based on this time of the year. According to Jeff Hirsch of the Stock Trader's Almanac, the trading days after Christmas through the first 2 days of January, the stock market has risen almost 3 out of every 4 years. The Dow Jones has produced an average gain of about 1% during this period[1]. The causes for the "Santa Claus Rally" are more uncertain, with theories like mutual fund rebalancing, year end bonuses being invested, or maybe that everybody is in

[1] http://jeffhirsch.tumblr.com/post/168445014278/santa-claus-rally-is-coming-but-not-just-yet.

the buying spirit this time of year. No one can prove anything to correlate the underlying cause for this ‘rally’.

What does this mean for the clients of Prato Capital Management? Not much. The financial planning tools used for your Financial Life Plan is based on decades of market history and any ‘Santa Claus Rally’ is included.

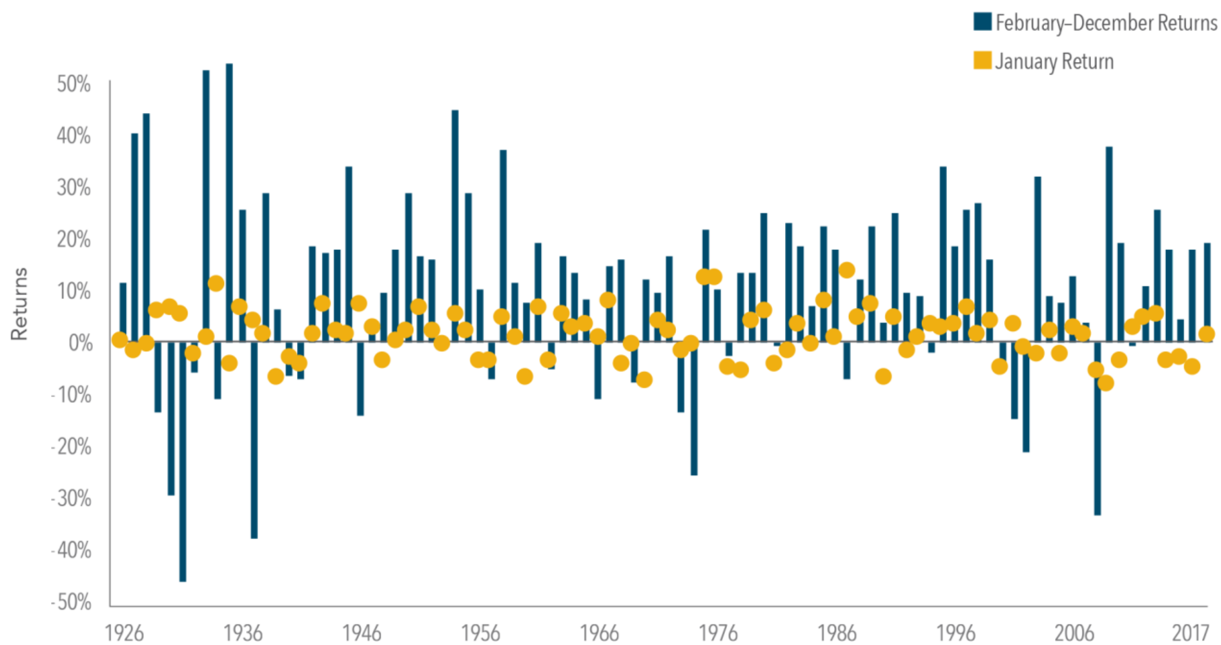
The January Effect

The other theory that is often spoken of this time of the year is the January Effect. This theory suggests that the price movement of the S&P 500 during the month of January may signal whether that index will rise or fall during the remainder of the year. In other words, if the return of the S&P 500 in January is negative, this would forecast a declining stock market for the remainder of the year, and vice versa if returns in January are positive.

So, have past Januarys’ S&P 500 returns been a reliable indicator for what the rest of the year has in store? If returns in January are negative, should we sell stocks? Exhibit 1 below shows the monthly returns of the S&P 500 Index for each January since 1926, compared to the subsequent 11-month return (i.e., the return from February through December). A negative return in January was followed by a positive 11-month return about 60% of the time, with an average return during those 11 months of around 7%.

This data suggests there may be an opportunity cost for abandoning equity markets after a disappointing January. Take 2016, for example: The return of the S&P 500 during the first two weeks was the worst on record for that period, at -7.93%. Even with positive returns toward the end of the month, the S&P 500 returned -4.96% in January 2016, the ninth-worst January return observed from 1926 to 2017. But a subsequent rebound of 18% from February to December resulted in a total calendar year return of almost 13%. An investor reacting to January’s performance by selling out of stocks would have missed out on the gains experienced by investors who stuck with equities for the whole year. This is a good example of the potential negative outcomes that can result from following investment recommendations based on an “indicator.”

Exhibit 1. **January Return vs. Subsequent 11-Month Return of the S&P 500 Index**
1926–2017



In US dollars. S&P 500 Index data provided by Standard & Poor's Index Services Group. Past performance is not a guarantee of future results. Indices are not available for direct investment; therefore, their performance does not reflect the expenses associated with the management of an actual portfolio.

The Bottom Line

Using a month or a day of the calendar as an investment strategy may sound like a way to get an edge when investing. The reality is much more obvious. Stock prices do not go up or down because of the day or the month. Rather than trying to beat the market based on hunches, headlines, or indicators, at Prato Capital Management we remain disciplined and use strategies based on 100 years of market history.