Investors Crave Simple Rules

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One of the simplest rules for investment decisions is the advice to "sell in May and go away." However, it is only March, so let us take some time to focus on the most important seasonal effects.

US Investor's Rule of Thumb: the Super Bowl

In investor circles, there are many rules of thumb that seemingly guarantee successful investments. The start of the year is when these rules "bloom" so to speak, not least of all because investors are asking themselves what the new year may bring in the way of performance.

The basic idea behind these rules is to predict what direction financial markets will take in the immediate future (that is, in the current year) using both financial and non-financial indicators. One example of a well-known non-financial indicator is the **Super Bowl Indicator**.

The Super Bowl is played between the American Football Conference (AFC) champion and the National Football Conference (NFC) champion on the last Sunday in January. According to the Super Bowl indicator, if the NFC wins, the stock market will end the current year on a positive note, and the stock market will dip into negative territory if the AFC wins.

Statistics show that in 26 out of 30 years in which the NFC team won the Super Bowl, the S&P 500 rose on average by 12.3% by the end of the year. Yet, in the 13 years in which the AFC team was victorious, the S&P 500 Index lost an average of 2.35% of its value.[1]

Rule of Thumb for Every Investor: the January Effect

Another one of the most widely known rules hashed over by the media at the beginning of every year is the so-called **January Effect**. The rule simply predicts that the capital market's performance during January will determine its performance for the entire year: "As goes January, so goes the year."

In other words, if the month of January produces a positive yield, then the year will end on an overall high note and vice versa if January yields negative results.

The following table shows an analysis of the January Effect for select stock indices between 1994 and 2012:

Index:	% Agreement:
SMI	58 %
DAX	63 %
FTSE	58 %

[1] "What happened to the Super Bowl Stock Market Predictor?", George W. Kester, Journal of Investing 19, No. 1 (Spring 2010), pp. 82-87.

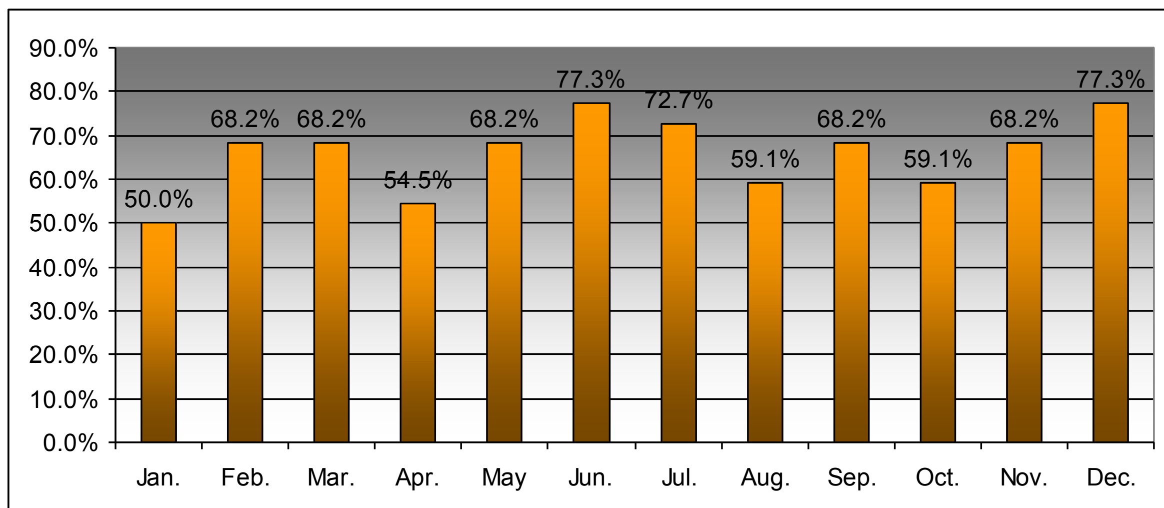
[2] Please see also, for example, "How Accurate is the January Barometer?", Ben R. Marshall, Nuttawat Visaltanachoti, 2008; "The

S&P 500	63 %
NASDAQ Composite	63 %
CAC 40	74 %
Nikkei 225	47 %
Hang Seng	58 %

In 58% of the periods under observation, a positive yield in January was accompanied by an upswing for the year as a whole, while a downward slide in January was followed by a negative yield overall for the year. The CAC 40 even indicates a 74% agreement for the period analyzed.

Why should January and not some other month be able to predict the yield for an entire year? According to conventional wisdom, January is the month in which people reorganize their holdings and invest more in equities.

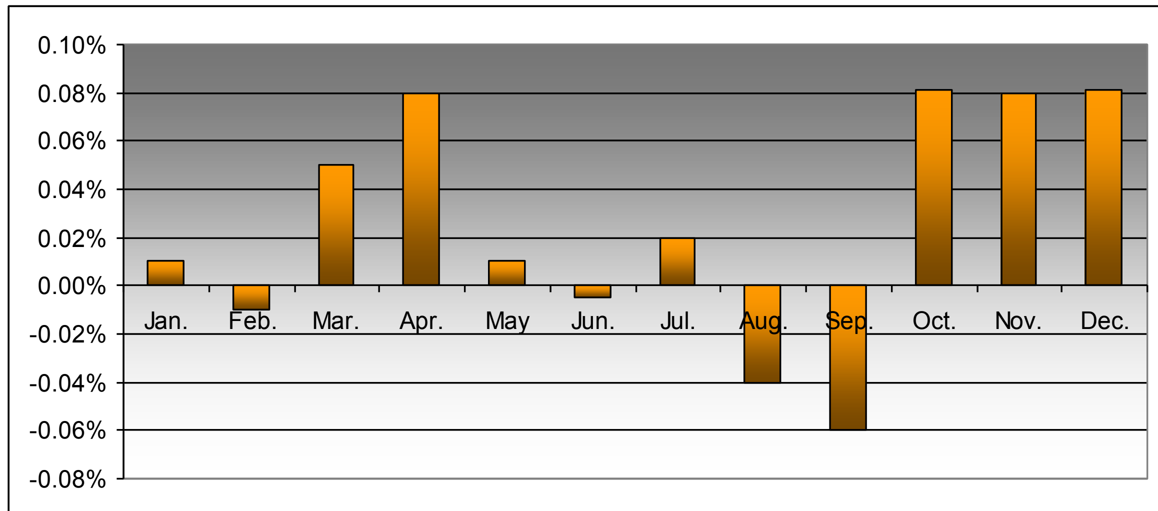
Empirical analysis of the correlation between the rise or fall in the yield for any given month and the rise or fall in annual yield (a positive yield for the month is followed by positive yield for the entire year and vice versa), however, produces the following, rather sobering picture of the SMI for the period of 1991-2012:



Over the past few years at least, the January Effect in Switzerland has displayed no reliable predictive power.

Highest Daily Yields in April and in 4th Quarter

Analysis of the daily (rising) yields of the SMI also shows that the months of April, October, and November of the period under observation produced the highest average daily yields.



Realize Gains in May

Once more, investors will have to ask themselves this year if they want to take at least part of their profits from shares. **"Sell in May and go away..."** is another rule of thumb that could be readily trusted with a fleeting glance at the chart above.

Attempts at explanation make sense. The amount of significant fundamental data based on interpretation of a company's annual accounts (usually in February or March) and forecast (referred to as "guidance") and its confirmation when the results for the first quarter of the new year are published in May flattens out considerably with predictable consistency.

Viewed empirically, this means investors should wait an extra two months, until the end of July, before selling. This may be a nuance, but in nearly every country, poor results can be measured in the months of August and September.

Experience has shown that trading activity is slow in summer. Only toward the end of the year (after the Q3 earnings reports) does the sly game played by financial analysts revolving around revised sales, earnings, and profits continue at a frantic pace. That is why the adage ends with **"...but remember to come back in September";** in other words, be prepared for the final quarter.

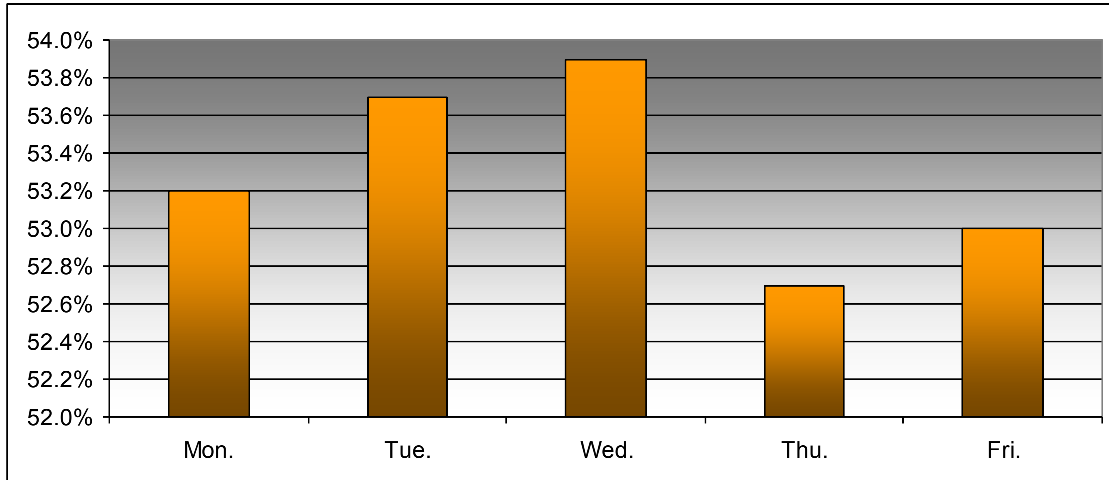
Market Timing Has an Impact Even During the Week

Closer examination of weekly yields reveals Wednesday to have the highest number of positive returns.

One explanation for this lies in the observation that most companies try to plan their financial calendar so that reports are published before the market opens on one of the first three trading days.

In Switzerland, this also has side effects, such as enabling data from the latest reports to be published in the weeklies ("Handelszeitung", Wednesday edition of "Finanz und Wirtschaft"). News

that comes out on Thursday mornings tends to get overlooked. It might be an entirely different ball game in other countries where media practices are different.



What Are Professional Investors to Do with These Seasonal Effects?

Why on earth should people not make investments on the basis of the above described rules? The statistics look pretty convincing, don't they?

There are several problems with using these sorts of rules of thumb to make investment decisions. Let us point out the biggest risk associated with them: One should be extremely cautious when dealing with investment rules based on correlations proven purely by statistics but which lack any financial logic whatsoever. **Correlation does not imply causation.**

There is no plausible reason why the winner of the Super Bowl ought to predict the movement of the stock market. Be wary of hasty misinterpretations of pseudoscientific "evidence." More accurate studies[2] show, for example, that the January Effect cannot be credited with any statistically significant ability for predictive power.

Rules of thumb and indicators like the Super Bowl or the January Effect are meant more for amusement or conversation at a cocktail party than as serious advice on how to make investment decisions.

On the one hand, these kinds of rules can wreak havoc on a portfolio. On the other, even more convincing rules such as leaving one's investment alone for a few months after May to reduce the stock market risk can primarily help banks earn commission income.

Behavioral finance teaches us that men in particular are susceptible to an activity problem: "We can't just lie back and do nothing." However, this rule does not apply at home. Just ask your wife. Or maybe, we have to share the view of Mark Twain who summed up more than 100 years ago: “All generalizations are false, including this one.”

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[2] Please see also, for example, "How Accurate is the January Barometer?", Ben R. Marshall, Nuttawat Visaltanachoti, 2008; "The January Barometer: Further Evidence", Lawrence D. Brown, Liyu Luo, 2006.

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