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The Polaris Perspective

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The January Effect

The financial industry is full of catchy phrases to help investors understand or remember investment techniques. The "January Effect" is a widely known term. The concept is, "As January goes, so does the rest of the year." In other words, January's return should predict the subsequent return in the stock market during February through December. The January Effect has been more than 70% accurate at predicting the following months of the year over the past 64 years. The S&P 500 experienced a -3.56% loss in January of 2014. Does that mean that the S&P 500 will experience a loss during the rest of the year?

Before you sell all of your stocks and take the year off of investing, you should read the whole article. As you know, statistics can be misleading. The January Effect is a good example.

Prior to this year, there had been 24 times that the S&P 500 experienced a loss in January dating back to 1950, or a little more than a third of the time. Of those 24 times that January was negative, February through December was negative only 11 times, approximately 46% of the time. That's less accurate than flipping a coin to determine the upcoming months.

It gets worse if you look at more recent years. There have been 12 negative Januaries from 1980 through 2013. Only 4 of those Januaries had additional losses in the remaining months of the year. That's only a 25% accuracy rate.

Is the January Effect accurate when January is positive? Sort of… It depends on how you look at it. There have been 40 positive Januaries from 1950 through 2013. February through December was positive 35 of these 40 occurrences, or over 87% accurate. The issue that I have is the S&P 500 has been up annually almost 80% of the time during the same period. So is it that the markets generally go up, or is there a correlation between a positive January and the rest of the year?

Personally, I think the phrase should go something like this, "As January goes, so does the rest of the year if January is positive. Then again, the markets generally go up so a positive January might not mean a thing. If January is negative, flip a coin. You'll be more accurate."

As always, I look forward to your comments and questions.

Sincerely,

Jeff