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The January Effect in November?

Wow! What an incredible nine months we have had to start off the year. It is hard for me to fathom that as I am writing this article, one-year ago today, September 29, 2008, the Dow Jones Average dropped an astonishing 776 points or the equivalent of 8.8%! It seems like a distant memory now, but hopefully the better times that we are enjoying now will not lull us into a false sense of security. There are still many problems to fix, and though we are sitting in an infinitely better position than 12 months ago, we must try to learn from our past mistakes and avoid repeating history moving forward.

On a lighter note, I'd like to take the next few paragraphs to expand the *Mythbusters* theme presented in our 2nd quarter newsletter to another famous Wall Street myth. For those who read our 2nd quarter newsletter, you'll notice that the old adage we examined "Sell in May and Go Away" proved to be unquestionably wrong in 2009. So, why not statistically check the validity of another revered Wall Street myth, "The January Effect."

The original theorem refers to the tendency of the Stock Market to rise in the month of January. In particular, small cap stocks -- generally those with a market capitalization of less than $2 billion -- will rise more than mid cap and larger cap stocks in January. The underlying rationale is that smaller stocks are more illiquid, and they can more easily be beaten down by year-end tax-related selling. As logic would dictate, these battered down stocks tend to rebound more sharply once the selling for tax purposes dries up and new buyers emerge. On the surface, that theory seems plausible; but what do the numbers say? According to the *Stock Trader's Almanac*, over the last few years, the January Effect has actually morphed into the mid-December effect. From 1953 to 1995 small caps outperformed large caps an astounding 40 out of 43 times. But, since then, the Effect has been much less accurate in predicting performance. What happened? Well on Wall Street, if something works you can bet that the professional market timers are going to try and take advantage of it. Now it seems that the professionals are getting a head start on the individual investors by buying small caps a week or two earlier so as to capture the "January Effect" in mid-December.

Seems pretty smart -- but, how did those investors do last year? From the end of December '08 until the end of January '09, small cap stocks (as measured by the Russell 2000) were down 11.2% versus large cap stocks (as measured by the S&P 500) which were down 8.6%. What if we compare the two indices under the new mid-December notion? If we use December 15th as the start date, the changes are noticeable. The Russell 2000 was down 2%, where as the S&P 500 was down 4.9%.

So, what's the verdict? In the strict interpretation of the "January Effect," I think we can say that the once proven seasonal phenomenon is busted. But, I'm not ready to say that there is no causal relationship. Perhaps, we should call it the mid-December Effect, or who knows, in a few years maybe the November Effect! Either way, I think what we can take from this lesson on an old Wall Street adage is that if we try to time the market to take advantage of these past trends we will lose more than we win.

-Walter Hinson, CFP®

2009 Market Update

S&P 500	+19.3%
DOW	+13.5%
NASDAQ	+34.6%
MSCI World	+30.5%

Mortgage Rates

15-Year	4.5%
30-Year	4.9%
1-Year ARM	4.5%

Did You Know?

The Worker, Retiree, and Employer Recovery Act signed into law last December waives any required minimum distributions (RMDs) for 2009.

Wall Street was laid out behind a 12-foot-high wood stockade across lower Manhattan in 1685. The stockade was built to protect the Dutch settlers from British and Native American attacks. Hence why we now call it the Stock Market.

What’s the worst mistake you can make with beneficiary designations?

Are you setting your family up for a big battle after your death? Unfortunately one of the things that I see all too often is the disintegration of family relationships at the death of a loved one. A parent or grandparent may be the glue that binds a family together, and once they have passed away, a lot of the historical conflict in the family rises to the surface.

Contrary to what you might think, the main disputes have little to do with the estate or money but are simply a rekindling of prior transgressions – old wounds opened up. Major disputes erupt over distribution of family furniture and heirlooms, most of which has little financial value. Other disputes involve a perceived lack of fairness in the way a decedent may have assisted one beneficiary during life.

These conflicts can and will lead to litigation, such as a challenge to the validity of the Will. More often, estate litigation may involve a challenge to the way the Executor is administering the estate, particularly where the Executor is also one of the beneficiaries. In any case, once the beneficiaries hire lawyers the battle lines are drawn. Regardless of the outcome, everyone loses because of the unnecessary legal expenses.

So what can you do to avoid these problems if you are aware of inherent conflict in your family? The best advice I can give is to encourage communication. Talk to your family and beneficiaries. Tell them your wishes and your intent. You don’t need to give them all the details, but try to give them some general idea of what to expect. This may be an uncomfortable discussion in many cases, but it can make a real difference.

However you also have to be careful how you communicate on these issues. Your validly executed Will is the final word on your intent and your distributions and it will control over any oral statements you may make about your wishes. Whatever you do, please don’t tell your beneficiaries what they want to hear and then provide for something different in your Will – that is asking for a fight. Remember communication can go a long way towards heading off these disputes and even helping heal the wounds that feed these issues.

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Where Do the Markets Go From Here?

Recession? What Recession? There is no recession in the stock market the last 6 months as all the broad indexes have enjoyed huge gains with the S&P 500 up 60% from the March lows. Whether you participated in this rally or not is irrelevant at this point (except to our egos), and what is important is predicting whether this rally still has legs.

From a technical stand point the markets are extremely strong right now, and there is little if any technical resistance for the S&P500 heading to 1200 (a 12% gain from current levels). Should we reach 1200 on the S&P it is in all likelihood that the "fast" money will have been made from the oversold levels seen in mid-March.

If you’re looking for a spot to take some gains the 1200 resistance levels on the S&P 500 are a good starting point. At this price level the markets will be pricing in an expectation of approximately 4% GDP growth in our economy. Being that U.S. GDP growth has averaged closer to 3% for the past 2 decades and that we are entering an era of tighter lending standards 4% looks overly optimistic from our view point.

In short, proceed with caution.

-Ryan Glover, CFP®

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