Schroders

Markets

The '75%' chance that the Santa Rally exists

Stockmarket superstitions should be treated with caution. However, analysis of decades of data suggests December has normally been a good month for equities.

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Stockmarkets are more likely to rise in December than any other month, according to analysis of nearly three decades of data.

The analysis conducted by Schroders, which covers the world's largest markets, adds to the debate over the existence of the "Santa Rally", an alleged effect often dismissed by seasoned investors.

Our analysis measured two definitions of the Santa Rally: the month of December; and the seven trading days immediately around the Christmas period.

Stockmarkets most likely to rise in December

The chart below combines data for the FTSE 100, S&P 500, MSCI World and Eurostoxx indices to show the frequency, in aggregate, with which they rose in each month since 1988.

The analysis clearly indicates that December has been the strongest month, with markets rising 75% of the time. April is the second best performer, with a figure of 70%. This is in contrast to the months of June, August and September which saw falls more often than a rise.

Looking at a specific index as an example, the most extreme case of monthly disparity was for the MSCI World Index. The index is seen as a broad global equity benchmark which reflects large and mid-cap equity performance across the world. It has finished higher in December on 22 of the last 28 years; 79% of the time. This compares to its June performance when it only rose 36% of the time.

However, it is worth noting that if you'd have invested in the MSCI in 6 of the years that it had fallen in December, you could have made a loss between -4.95% and -0.17% depending on the year.

But why?

There is much speculation on why stockmarkets rise at this time of the year, giving life to the terms "Santa Rally" or "December effect". One theory is based on investor psychology. There is more goodwill cheer in the markets due to the holiday season putting investors in a positive mood, which drives more buying than selling.

Another view is that fund managers, which account for a substantial part of share ownership, are re-balancing portfolios ahead of the year end.

The real 'Santa Rally'?

Some analysts say that the true Santa Rally is defined by the last five trading days of the year and the first two days of the new year.

This was a trend identified by Stock Trader's Almanac publisher Yale Hirsch in 1972. It still carries some weight today, as our research shows.

The table above sets out the returns for this seven-day period across a number of indices around the world. It shows the probability of each index rising, along with its average performance. The data stretches back to different starting points.

The UK market appears to show the strongest Santa Rally tendencies. Since 1993, the FTSE 250 has only fallen on one occasion over these seven trading days.

The Dow Jones Industrial Average and the S&P 500 also show positive market sentiment at this time of year.

Interestingly, the Nikkei performs markedly worse over this period in comparison to some of its peers. Not only has the index only risen 61% of the time in 33 years, but the average rise was only 0.49%. The highest average rise was 2.29% for the UK's FTSE 250.

Japan doesn't celebrate Christmas to the same extent as the West, which could explain why the Nikkei's performance is less dramatic, if you subscribe to the notion that festive spirit can move markets.

The danger of superstitions

The Santa Rally is just one of many investing superstitions. Perhaps the most famous in the UK is the adage "sell in May and go away, buy again St Leger Day".

The theory is that the summer months are usually the worst performing, and investors are best to sell up in May and hold cash until early September – until the St Leger horse race.

Of course, 2016 has been a year like no other with markets moving amid extraordinary political uncertainty. As a case in point, those that would have sold a notional basket of FTSE 100 stocks at the index's highest point of the year in May, at 6271 points, would have missed out on an 8% gain by St Ledger's Day (September 10th, FTSE 100 at 6777pts).

Simply put, stockmarket superstitions are true…until they fail to be. Those looking to gamble simply on Santa spreading his goodwill around the markets again this year do so at their own risk. Investing should be for the long term- not just for Christmas.

Income IQ (http://incomeiq.schroders.com/en/) - Test your own investor psychology with our Income IQ test

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