



Will We See A Santa Claus Rally?

SYNOPSIS

- A “Santa Claus rally” is the phenomenon of equity markets trending upward during late December.
- Tax planning, holiday bonuses, and buying in anticipation of a rise in stock prices during the month of January are just a few theories behind these rallies.
- There are an infinite number of reasons why stocks will rise or fall in a matter of days.

HO, HO, HO?

Tis the season for that time again when the media poses the question of whether we will get a “Santa Claus rally” in a few weeks. This fabled market term describes the rise in equity markets often experienced at the end of the year.

According to the 2016 Stock Trader’s Almanac, the Santa Claus rally, which consists of the last five trading days of the year and the first two trading days of the New Year, has yielded positive returns in 34 of the past 45 holiday seasons. The average return over this period has been 1.4%, which is not bad for just seven trading days.

History seems to indicate that the Santa Claus rally is very real, but before the excitement of a jolly old man in a red suit bringing stock gains to all the good boys and girls overcomes our cognitive defenses, let’s dig a little deeper.

Here are a few of the more widely accepted theories from leading academics and market pundits that contribute to the Santa Claus rally:

- **The “January Effect”:** This is a seasonal anomaly where equities often increase during the month of January. Traders who anticipate the January Effect will buy stocks in December to get in front of yet another seasonal trend.

- **Tax Considerations:** Investors move their portfolios around when implementing tax strategies to lower what they will owe to Uncle Sam for the year.
- **Emotional Wall Street:** Investors are regarded as being more optimistic around the holidays, year-end bonuses are invested, and many Scrooge-like traders go on vacation.
- **Will It to Happen:** So many traders expect a Santa Claus rally that their synchronized activity becomes a self-fulfilling prophecy.

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It is certainly plausible that these drivers could fuel another Santa Claus rally this year, but do not consider that to be a hall pass to trade because a very compelling case could be made for stocks to fall instead. Consider the following:

- **Already Up:** The stock market has already done quite well over the past two months, so traders may choose to sell and lock in healthy gains acquired since early November.
- **Rising Rates:** The Fed’s decision to raise interest rates and forecast further hikes could spook traders who buy/sell based on Fed policy decisions.
- **Remember Last Year:** Last January was a brutal month for stocks, and traders may go to cash in anticipation of a repeat to start the year.
- **End of the World:** According to The Sword of God Brotherhood, which is a European cult guided by predictions based off the Mayan calendar, the end of the world will occur on January 1, 2017. There may be a flight to safety right before the Aliens arrive to save only those who



reside on the side of a specific mountain in Bugarach, France.

Said another way, no matter how many reasons can be conceived for why a Santa Claus rally could arrive, the list of reasons why the exact opposite could occur is equally as large.

IMPLICATIONS FOR INVESTORS

There are practically an infinite number of reasons why stocks will rise or fall in a matter of days, so determining which will happen and subsequently drive stock prices is impossible. This is why day trading is textbook gambling.

What can be done is isolate what will move stocks over the long run and buy those because (1) there are only a few fundamental, long-term drivers and (2) they can be observed and measured.

For example, if Apple's stock price rises over the course of a day or two, there could be a countless number of drivers over those few hours. However, if the stock price rises slowly over 2-3 years, it is probably because they are selling more iPhones, iPad, and other goods.

Therefore, since any Santa Claus rally is too short for the fundamentals to fuel stocks, my plan this holiday season is going to be simple. I plan to do nothing at all.

If it does happen, then it will be a great ending to a crazy year. If stocks sell off instead, then I may look to go discount shopping if deals emerge that are too good to pass up. Nevertheless, what will not happen is making any moves in anticipation of a year-end move.

The bottom line is that a Santa Claus rally makes for good banter on financial news networks, but it will have no bearing on the long-term direction of stock prices.

Sincerely,

A handwritten signature in black ink, appearing to read "Mike Sorrentino".



Mike Sorrentino, CFA
Chief Strategist,
Aviance Capital Management
mikeonmarkets.com

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