

CHAPTER 1**Introduction to
Seasonality in
the Stock Market**

Within nature there exists an undeniable ebb and flow. The sun unfailingly rises in the east and then sets in the west. The moon revolves around the earth. The earth revolves around the sun. Trees grow leaves in the spring. The leaves turn bright colors in the fall and by winter they have fallen to the ground. The following spring the same routine starts anew. Most people go to bed at night and rise in the morning. What happens in nature affects humans, not only physically, but also emotionally and psychologically. Thunderstorms instill fear and a desire to seek shelter. A blizzard triggers an urge in people to hunker down and cocoon at home under a blanket. A dark, dreary day has an undeniable tendency to cause many people to experience—for lack of a better word—a funk, a state of mind in which virtually nothing feels right. But, ah, a warm, sunshine-filled day can all by itself suddenly make everything feel right. For millennia, the human race was a slave to the sun. And, to this day, people are drawn to bask in its glow. To better understand this phenomenon, picture opening the drapes first thing in the morning on a cloudless, sunny day following three days of dreary weather. Suddenly, almost magically, the darkest of moods seem to melt away.

So, what does any of this have to do with the stock market? The heart of the matter comes down to the fact that humans are a creature of habit and repetition, and that many, many things in life happen on a cyclical basis. And these cycles can greatly affect the way a person thinks or feels. Let's first consider the concept of seasons.

THE CONCEPT OF SEASONS AND SEASONALITY

Virtually everyone is familiar with the concept of a season. We can start with winter, spring, summer, and fall. Add in hunting season, football season, mating season, hurricane season, holiday season, and so on. Factor in “a season for all things,” “now is the season of our discontent,” “the seasons changed and so did I,” and you start to get the idea.

In a nutshell, in many aspects of life things occur in a repetitive pattern. Spring follows winter, then summer, fall, and then winter again. Things do in fact change over time. Yet, the basic underlying idea of seasons and seasonality is that although things do change, they often return to a particular state over and over again—often in a very cyclic and predictable way. Over time, the human mind comes to understand the cyclic or seasonal nature of certain occurrences and begins to adapt. In the old days in cold-weather climates—before the advent of heat and running water—humans used to gather up provisions as the fall progressed to ensure that there would be enough food to last the winter. Nowadays, many individuals in cold-weather climates use the beginning of baseball spring training in February as something to latch onto to help get them through the remaining cold months of winter and to remind them that better (or at the very least, warmer) days are certainly ahead. Today, many people living along the Atlantic Ocean or the Gulf of Mexico make preemptive plans regarding the potential for hurricanes during the late summer and fall months.

So what, you might ask, does any of this have to do with the stock market? I mean, certainly, one might be willing to grant the notion that weather-related seasonal trends could have an impact on commodities and grains. Things that grow in the ground or that eat the things that grow in the ground clearly can be affected if the ground is too wet or too dry (or covered with three feet of snow) and does not allow for the normal planting process to proceed. But the stock market is primarily based on financial assets, not physical assets. As long as the New York Stock Exchange has electricity, the nature of the weather outside is seemingly irrelevant. And the Nasdaq market doesn't even operate a physical exchange. So, here too, the vagaries of weather and seasons would at first blush seem to be quite irrelevant. But the reality is that there is more to cyclicity, seasons, and seasonality than mere weather.

In many cases, seasons become a state of mind. As I have already described, in many instances, people prepare for certain recurring events, proceed as planned during the period in question, and then relax and redirect their energies in different directions once the anticipated cyclic or seasonal period or event has passed. In summary, human emotion becomes intertwined with cyclical trends.

So, to sum up so far, we all accept the fact that many things in life are seasonal in nature, or cyclic. Most of us recognize and accept the notion that people's thoughts, attitudes, and emotions can change with the seasons. This is an important connection, because the stock market can be thought of as the ultimate arbiter of human emotion as it relates to all things financial.

It can be argued that the stock market experiences seasons or cycles. At the very least, one can make the case that there are bull seasons, when the stock market advances, and bear seasons, when the stock market declines. In addition, one could argue that there are at least two or three other seasons in the stock market:

- A pullback in a longer-term bull market.
- A rally in a longer-term bear market.
- An extended trendless period.

Although none of these seasons are related to weather and although bull markets and bear markets certainly cannot be counted on to always begin and end on the same dates each year, the fact remains that these seasons are a fact of life for stock market investors. As such, most investors ultimately have to learn to deal with the inevitable change of seasons in the stock market.

Whereas many individuals try to deal with these seasons as objectively as possible, ultimately, much of the decision-making process comes down to emotion. As a result, the gyrations of the stock market have a direct relationship with human emotion that is deeply intertwined. At times, the fluctuations of the stock market can cause mass changes in the overall emotional state of market participants. Likewise, at other times, the emotional state of market participants as a whole can exert a direct effect on the direction of stock prices. In essence, what happens over time is that the season for investors moves from greed to complacency to fear, and then the process repeats. To better understand this change of seasons, let's consider a typical stock market cycle and how it affects investors' thinking and vice versa.

The initial stages of a bear market are generally marked by denial, as investors who have become used to making money can't bring themselves to believe that the good times have come to an end. As the bear market unfolds, more and more investors eventually bail out—often swearing never to risk their hard-earned money again—whereas others cling to every countertrend rally, hoping that it is the start of the next bull market. As the bear market reaches its low, fear typically ramps up and ever more people decide they can't stand the pain of losing money anymore. At a major stock

market bottom, there is typically great despair among investors. And, at about this time, the season changes. The stock market no longer continues to make new lows but, in fact, may stage a strong rally off of a low. With human nature being what it is, many investors refuse to believe that the bottom is in. And, they refuse to be sucked into the market once again in fear that another plunge is in the offing. But, even as these former investors stand aside and get left behind, the season is changing back from bearish to bullish. As the bull market continues, optimism grows and investors flock back to the market, looking to make their money grow. Eventually, concerns of downside risk give way to fears of missing out, and money pours into stocks of all stripes and colors. As optimism and complacency reach their peak, the stock market tops out once again. It is often said that the masses are right in the middle and wrong at the extremes. In other words, the majority of investors are typically too bullish at the top and too bearish at the bottom. And, in my experience, this adage has proved to be true.

One of the key factors that drives emotion when it comes to investing is the fact that it involves the potential increase—or decrease—in one's hard-earned money. Making or losing a lot of money quickly tends to have strange effects on people. For example, in most instances, people prefer to buy something when the price is lower. If an item cost \$20 yesterday and today costs only \$18, most people will be more attracted to that item today on the basis that it now represents a better value than it did yesterday. When that item comes to the stock market, however, this is not always the case. This is partly because no one can ever be sure how low is low. In other words, it is possible for the stock of a given company to go to zero if the company goes bankrupt or out of business. The fear of this potential outcome always lingers in the back of investors' minds. And, as a result, a decline in the price of a stock more often is likely to persuade someone to sell that stock than it is to persuade someone to buy it. In other words, the thinking eventually changes along the following lines.

I bought it at \$22 because I thought it was a value. At \$20 I figured it must be an even better value so I bought some more. At \$18 I started to wonder whether maybe my analysis was a bit early in selecting this stock as a value. At \$16 I started to think seriously about cutting my losses. By the time the stock reached \$14, I couldn't take it anymore and decided to bail out. As the stock hit \$10 a share, I realized that it was one of the biggest dog companies to ever exist so I decided to sell it short. Three days later, it was back over \$14 and I finally realized that I had no idea what I was doing.

And, so it goes. In some ways, buying a stock can be viewed along the lines of finding a mate. Investors first identify and become involved with an attractive stock. But, as happens sometimes, things go south. As the price of the stock declines, investors first attempt to remain convinced that the stock is attractive. Eventually, investors realize that this mate is

trying to take them for all they are worth. Painfully, investors accept the fact that they were wrong and that they must terminate the relationship. After that comes the remorse and recriminations. Now, clearly this cycle does not play out just this way with every stock purchase (nor, thankfully, with every relationship). Still, it only takes one or two of these types of experiences for the pain associated with them to be permanently seared into an investor's psyche. And, this memory can strongly affect the way one looks at other future relationships.

Investors who suffer a loss beyond what they had expected will typically be gun shy for a good long while into the future, as they do not wish to repeat this unpleasant experience. They may find themselves bailing out of positions at the first sign of trouble, only to then find themselves on the sidelines when the rally starts in earnest. Likewise, investors who achieved a quick profit and then watched it vanish, never to return, may be very quick to take profits in the future. These are just two simple examples of how the market can affect an investor's thinking, and how that thinking can affect the actions that take place in the stock market. Clearly, investors' moods and outlooks change as the investment season changes. And, just as clearly, changes in the moods and outlooks of the majority of investors can affect the investment season.

So is it that much of a stretch to believe that the stock market could have seasons? That is the question that this book will attempt to answer.

WHAT IS SEASONALITY?

The Merriam-Webster online dictionary defines the words "season" and "seasonal" as follows:

Season: a period characterized by or associated with a particular activity or phenomenon.

Seasonal: of, relating to, or varying in occurrence according to the season.

For our purposes, we will use the word "seasonality" to define any number of seasonal trends that seem to exist in the stock market. We will define the phrase "seasonal trend" as a recurrent period characterized by certain occurrences—most notably, a tendency for the stock market to rise (or fall) in price. The seasonal trends that I will detail in this book will be outlined in a moment. For now, let's define what seasonality is not.

You must accept the fact that seasonality in the stock market is not a magic formula. Throughout this book we will be looking at a variety of seasonal trends, each with specific buy and sell dates. And, as you will see, the results for many of these seasonal trends have accumulated an extremely impressive track record. And, to some individuals, it might seem to make sense to use these trends on a systematic basis. But that is a determination that each investor must make on his or her own. In the end, the goal of this book is to convince you that seasonality has a place in your investment strategy. However, the goal is not necessarily to try to convince you that you should rely solely on seasonal tendencies to the exclusion of all other analyses.

The best analogy that I have heard for describing the proper way to look at seasonal trends in the financial markets came from Michael Santoli in his *Barron's Financial Weekly* "Streetwise" column from November 26, 2007. In that particular column he stated the following:

"Seasonality is climate, not weather."

Although this comment may not make intuitive sense to everyone, it very accurately sums up the proper perspective that an investor should have when considering incorporating seasonal trends into an investment strategy. Just because it is December in Chicago does not necessarily mean that the temperature will be extremely cold. On an unseasonably warm day, the high in Chicago can reach above 50 degrees even during what is considered a winter month. Seasonality tells us that it should be cold, or more accurately, that it is more likely than not to be cold on a December day in Chicago, but the weather outside can vary widely. As we will see, the same is true regarding seasonal trends in the stock market. If a given time of year has been up 60 times in the past 70 years, we would intuitively look for that period to be bullish again this year. But whether this year ultimately falls into the normal bullish category or joins that smaller number of bearish aberrations cannot be accurately predicted in advance.

So the bottom line is that seasonality in the stock market should not be thought of as an exact science. Nevertheless, the other key piece of the equation is to recognize from the data presented throughout this book the powerful trends that seasonal patterns can help you to identify in the stock market, and the fact that seasonal trends should not be ignored simply because they are not based on hard fundamental data such as earnings or on a price-based technical indicator. In essence, a given seasonal trend is a form of a psychological or sentimental indicator, as each seasonal trend is a measure of the tendency of the investment masses to act in a certain way in a certain repetitive form. Before jumping into the details of the actual seasonal trends themselves, let's first take a moment to recognize some of the pioneers in the area of seasonally related research.

THE PIONEERS OF STOCK MARKET SEASONALITY

Whereas some individuals will look questioningly upon the notion of seasonality in the stock market, the fact remains that some of the best minds in the business have spent countless hours, and even years, conducting a great deal of research in the area of seasonal trends in the stock market. In the following text, I would like to give mention to a few of the early pioneers in the area of seasonal stock market research.

Yale Hirsch

It might be appropriate to refer to Yale Hirsch as the “founding father” of seasonal trend analysis in the stock market. He was the original editor and publisher of *The Stock Trader’s Almanac* (www.stocktradersalmanac.com), which has been published annually since 1967. As a result of countless hours of groundbreaking research, Hirsch became the leading analyst in the area of historical stock market behavior and cycles in different political and economic environments.

His most notable contribution to the area of seasonality is the much renowned January barometer. The premise underlying the January barometer is simply that as the month of January goes, so goes the entire stock market year. This method is discussed in-depth in Chapter 2 along with several variations. Other indicators that Hirsch has developed or popularized over the years are the Santa Claus rally (Chapter 4) and the best six consecutive months of the year (Chapter 8). In summary, Hirsch’s research over the years has helped many astute investors to profit in the stock market and has effectively served to legitimize the analysis of seasonal trends in the stock market.

It should also be noted that Yale Hirsch’s son Jeffrey Hirsch has followed in his father’s footsteps and become another major player in the area of research of seasonal market trends. Jeffrey is now the publisher of *The Stock Trader’s Almanac* and authored *The Almanac Investor: Profit from Market History and Seasonal Trends* (Wiley, 2005).

Norman Fosback

Norman Fosback authored the classic stock market book *Stock Market Logic* in 1976. Fosback was and is a serious student of the market and gained prominence in the 1970s and 1980s for implementing econometrics in his stock market analysis. He edited a newsletter titled *Market Logic* from 1975 until 1995. He also founded and was editor-in-chief of *Mutual*

Funds Magazine, one of the most widely read personal investment publications ever produced. But for our purposes, Fosback's most prominent contribution was in the area of stock market seasonality. It was from a research project that lasted from 1971 into 1975 that he developed his "seasonality switching system."

Much of what he discovered in his testing and incorporated into that original switching system is used throughout the pages of this book. The heart of Fosback's original research was the recognition that the period comprising the last trading day of the month and the first four trading days of the next month was by far the most favorable time of the month to invest in the stock market (Chapter 4). Over the years, the original system evolved and some of the rules became a bit more arcane (e.g., Fosback's Rule 5 states, "Do not own equities on the second day before a holiday closing if that day happens also to be the first trading day of the week"; Fosback's Rule 6 states, "Continue to own equities on the first day after a market holiday closing if that day is also the last trading day of the week"). Nevertheless, despite the seemingly arcane nature of some of the updated rules, the bottom line is that these changes may in fact result in better performance over the long run.

One ironic note: Although Fosback did do some research on individual stocks, the real heart of his analysis was based on the overall stock market itself. Unfortunately for him, virtually no index funds existed back in the 1970s and they became a viable investment choice only in the 1990s. Thus, whenever Fosback's methods generated a buy signal, he was faced with the task of building a portfolio or buying a stock mutual fund that would hopefully closely track the overall stock market averages. Nowadays, investors have an important advantage in that they can buy an index fund and instantly own a position that will accurately track the performance of a given stock index.

Dick Stoken

Dick Stoken authored a book titled *Strategic Investment Timing in the 90s* in 1990. In that book, he discussed something he referred to as the "investment climate." He claimed that this investment climate turned favorable on October 1 two years before the next presidential election, and that this favorable period extended through the end of the following (or preelection) year. This claim will be examined in much greater detail in Chapter 7, "Election Cycle Investing." For now, suffice it to say that Stoken did indeed speak the truth, and that this 15-month period has consistently provided investors with an above-average climate for investing in stocks.

Peter Eliades

Peter Eliades is a stock market analyst who gained prominence in the 1980s as the editor of an advisory letter titled *Stock Market Cycles*. As the name of his advisory service implies, Eliades has done a great deal of work in the area of identifying meaningful cycles in the stock market. One of his primary contributions to seasonal analysis that we will look at in this book is the 212-week cycle, which is discussed in Chapter 6, “Repetitive Time Cycles of Note.”

Much of what appears in this book is either taken whole or derived from the works of pioneers such as those individuals whom we have just discussed. As a self-admitted graduate from the School of Whatever Works, I greatly appreciate the fact that so many respected analysts have refused the initial urge to scoff at seasonality in the stock market and, in fact, have not only embraced the concept but also taken the time to do research in an area that some might consider arcane. Last, they were willing to share their findings so that the rest of us might benefit also.

**MEASURING MARKET PERFORMANCE
THROUGHOUT THIS BOOK**

This book is dedicated to the idea of highlighting a wide variety of seasonal trends in the stock market. One great thing about the stock market is that ultimately the success or failure of any idea can be quantified simply by running the numbers. If you can establish objective buy and sell rules for virtually any method you choose, you can then apply those rules and identify specific buy and sell points. From there you can simply compare the selling price to the buying price and determine whether a given trade generated a profit or a loss. You can also total and analyze for risk and reward characteristics the cumulative total of profits for all trades made according to a given method.

For the purposes of this book, we will use the performance of the Dow Jones Industrial Average (hereafter referred to as “the Dow”) in almost all cases to measure the performance of each given seasonal trend. Some will argue that this index is among the most narrowly based of all, as it consists of only 30 large-cap stocks and can at times differ significantly in performance from the performance of the average stock. But, for our purposes, this is acceptable. The benefits of using the Dow as our benchmark are severalfold. First off, there are well more than 100 years of history available for analysis. Nothing is ever guaranteed to work forever. Still, if a given trend or method tests well more than a century of data, it is fair to ask,

What more do you want? In other words, if 100-plus years of strong performance are not enough to convince you that a given method or trend is viable, then you are awfully tough to please.

In some ways investors today have it far better than those of just a few short years or decades ago. For example, in the discussion of Norman Fosback's analysis of seasonal historical trends, I mentioned the fact that prior to a certain time there was essentially no such animal as an index fund. Also, among the few that existed, there were some severe limitations regarding how often an investor could switch in or out of them. As a result, investors who wanted to take advantage of market movement had little choice but to buy a group of stocks that they felt would closely track the movement of the index they hoped to track. Sometimes this approach worked out fine, and other times it did not. In this scenario, it was possible to be exactly correct about one's expectation for the overall market, yet still lose money because the purchased stocks underperformed the index that one was trying to emulate.

Fortunately, for investors nowadays, it is a relatively easy task to replicate the performance of an index such as the S&P 500. This objective can be accomplished by simply buying an index fund, an exchange-traded fund, or a futures contract that tracks that particular index. Other choices include the Dow, the Nasdaq 100, and the small-cap Russell 2000 index.

One other thing that should be pointed out up front regarding the performance numbers that appear in this book is that we will use different starting points for different methods. There are two approaches that we can choose from. We can use the same starting date for each test of each different method, or we can start each test at a point where the method in question actually begins to start working. In other words, some methods might test well more than 100 years of data, whereas others might not have been of much use prior to, say, 1950. So, if we start the test for both methods 100 years ago, the first method will likely end up looking like the most effective over the entire test period. However, it is possible that the second method might have outperformed significantly over the most recent 50 years.

In a nutshell, a strong argument can be made either way regarding whether to start all tests for all methods at the earliest possible date or to choose different starting dates to test different methods. For the purposes of this book I have chosen the latter. Individuals who believe that methods tested over a shorter test period—and/or did not work particularly well prior to the chosen starting date—are less valid than other methods tested over a longer time frame are free to make their own determination regarding the reliability of the results that appear in this book.

HOW TO TRADE THE DOW

As I just mentioned, we will primarily be using the Dow as our benchmark for virtually all of the stock market performance testing to be done in this book. As I also mentioned, it is now possible to replicate almost exactly the performance of the Dow using an index fund. There are several choices, which I will detail next. It should also be pointed out that there may be times when an investor might wish to attempt to maximize his or her profitability by using leverage. Leverage simply means that your investment will fluctuate more than 1 percent based on a 1 percent price movement by the Dow itself. This can also be accomplished now using leveraged index funds. An index fund with a leverage factor of 2-to-1 will gain roughly 2 percent if the Dow rises 1 percent and will lose 2 percent if the Dow declines by 1 percent. Last, investors should also be aware that there are now inverse and leveraged inverse index funds available. The available funds for trading the Dow are listed in Table 1.1.

Investors who wish to branch out a bit more may consider using an index fund or exchange-traded fund that tracks the performance of the S&P 500 rather than the Dow. As you might guess, the S&P 500 Index is made up of 500 stocks, essentially all of the same large-cap variety as those that constitute the Dow. The correlation of the performance of these two

TABLE 1.1 Vehicles for Trading the Dow (Long, Short, and with Leverage)

Fund	Ticker Symbol	Type	Objective
Diamonds	DIA	Exchange-traded fund	Long the Dow; no leverage
Rydex Dynamic Dow	RYCVX	Open-ended mutual fund	Long the Dow*2
Profunds UltraDow	UDPIX	Open-ended mutual fund	Long the Dow*2
ProShares UltraDow	DDM	Exchange-traded fund	Long the Dow*2
ProShares Short Dow30	DOG	Exchange-traded fund	Short the Dow; no leverage
Rydex Inverse Dow x 2	RYCWX	Open-ended mutual fund	Short the Dow*2
Profunds UltraShort Dow	UWPIX	Open-ended mutual fund	Short the Dow*2
ProShares UltraShort Dow 30	DXD	Exchange-traded fund	Short the Dow*2

TABLE 1.2 Vehicles for Trading the S&P 500 Index (Long, Short, and with Leverage)

Fund	Ticker Symbol	Type	Objective
Spyder	SPY	Exchange-traded fund	Long the S&P 500
iShares S&P 500 Index Fund	IVV	Exchange-traded fund	Long the S&P 500
Rydex S&P 500	RYS PX	Open-ended mutual fund	Long the S&P 500
Profunds Bull	BLPIX	Open-ended mutual fund	Long the S&P 500
Rydex S&P 500 2x	RYTNX	Open-ended mutual fund	Long the S&P 500*2
Profunds UltraBull	ULPIX	Open-ended mutual fund	Long the S&P 500*2
ProShares UltraS&P 500	SSO	Exchange-traded fund	Long the S&P 500*2
Rydex Inverse S&P 500	RYURX	Exchange-traded fund	Short the S&P 500
Profunds Bear	BRPIX	Open-ended mutual fund	Short the S&P 500
ProShares S&P 500	SH	Exchange-traded fund	Short the S&P 500
Rydex Inverse S&P 500 2x	RYTPX	Open-ended mutual fund	Short the S&P 500*2
Profunds UltraShort Dow	URPIX	Open-ended mutual fund	Short the S&P 500*2
ProShares UltraShort S&P 500	SDS	Exchange-traded fund	Short the S&P 500*2

indexes over the years is sufficiently close enough that an investor who did not want to focus solely on the 30 stocks in the Dow index could generate similar results using the S&P 500. Just remember that at times the Dow will generate better results than the S&P 500 and at other times the S&P 500 will outperform the Dow. The key, then, is to pick an index and stick with it rather than chase the one that has performed the best over the past year, month, week, or hour. Table 1.2 displays a variety of index funds that an investor could use to trade the S&P 500 Index.

As you can see in Tables 1.1 and 1.2, there are many choices available to investors who want to trade these two large-cap indexes. In fact, there are possibly too many choices. But, ultimately, it comes down to three decisions:

Decision 1: Do you want to trade an open-ended mutual fund—typically through the mutual fund company itself—or would you prefer to trade an exchange-traded fund that you can trade through a regular brokerage account?

Decision 2: Do you want to play only the long side of the market—in other words, attempt to buy low and sell high when you think the market will rise and switch to cash when you expect the market to decline? Or do you also want to play the short side of the market, whereby you attempt to profit from a decline in stock prices?

Decision 3: Do you wish to use leverage any or all of the time? In other words, are you confident enough in your timing methods and risk-control procedures that you are willing to leverage your investment?

There are pros and cons associated with all of these choices. Exchange-traded funds offer you the convenience of being able to trade them anytime during the day, and they can be traded through a typical brokerage account just like any other stock. The downside is that you will likely pay a commission each time you buy or sell. Buying and selling through an open-ended mutual fund can typically be done with no transaction fees.

Being willing to trade the short side of the market opens up a number of additional moneymaking opportunities beyond those available to those who trade only the long side of the market. During a major bear market, the investor willing to trade the short side can actually accumulate greater profits than can the only-long trader, whose best hope is to be in cash and earn interest as prices decline. The risk, of course, is that the investor may be short in the market while the market stages a surprisingly strong rally.

Last, leverage is indeed a double-edged sword. On the one hand, if you have a method that consistently outperforms over the long run, then the use of leverage can help you to compound your returns exponentially and can generate vastly superior returns over the long run. The downside is that during those periods when losses occur, losses will be twice as great as they would have been if you had not used leverage. And the bottom line is that every investor has an uncle point, a point at which he or she feels compelled to act to eliminate the risk of losing more money altogether. The use of leverage can cause this point to come twice as quickly. So, typically, leverage is best used only when you are highly confident about your outlook and after you have carefully assessed the risks associated with what might happen if things move in the opposite direction of what you had expected. Nevertheless, the judicious use of leverage under favorable conditions can greatly enhance your long-term returns.

Clearly, any investor who ultimately decides to trade an index fund, to use any of the methods detailed in this book, you will ultimately have several important decisions to make. I encourage you to take your time and choose the vehicle that you feel best suits your objectives and tolerance for risk.

SEASONAL TRENDS TO CONSIDER

It is common for an individual approaching the topic of seasonal trends in the financial markets for the first time to be skeptical. And this is understandable. Still, what may surprise many readers is the sheer number of identifiable trends. In the following seven chapters, we will delve into and analyze a wide array of seasonal stock market trends. In each case, we will strive to identify specific and objective rules for using each trend. In other words, for virtually every trend we discuss, there will be a specific day of the week, month, or year designated as a buy date and another specific date designated as a specific sell date. The beauty of designating specific dates in this manner is that this process enables us to track the performance of a given strategy on a consistent and objective basis. This, in turn, enables us to make intelligent decisions about the potential usefulness of any particular seasonal trend and to compare the strength and consistency of performance for any given trends. The subsequent sections introduce the topics that we will discuss in the following chapters.

January

In 1971, seasonal analysis pioneer Yale Hirsch first detailed the famed January barometer. The basic theory underlying this method is that the performance of the stock market during the month of January acts as a harbinger of the action for the rest of the year. In Chapter 2, "The Month of January," I will examine the performance of the original January barometer over 70-plus years of history and will clearly detail the ways in which this storied tool is useful and not useful. I will also add a few new wrinkles to fine-tune our analysis of the month of January in ways that may help to maximize our profitability. To achieve this goal, we will look at several intramonth periods as further clues to the underlying strength or weakness of the stock market during this key month. Last, I will introduce something I call the "JayNewary barometer," which incorporates all of the key January measures and has demonstrated an accuracy rate of better than 90 percent in forecasting the performance of the stock market over the subsequent February through December period.

Holidays

Norman Fosback's original seasonality switching system first recognized the fact that the stock market tended to perform on a better-than-average basis during trading days that lead up to major stock market holidays. Since that time, many analysts have taken a closer look at the performance of the

stock market both before and after each holiday. One of the most comprehensive and useful guides was incorporated in Martin Zweig's 1986 book *Winning on Wall Street*. In that book, he looked at the performance of both the S&P 500 Index and a much broader unweighted average that more closely reflected the performance of the average stock. This was important at the time because, even then, most investors did not have a way to actually buy an index and had to resort to buying a group of stocks that they felt would closely track the movement of the overall market. Nowadays, an investor can easily replicate the performance of an index such as the Dow or the S&P 500 by simply buying an index fund, exchange-traded fund, or futures contract that tracks that particular index. Other choices include the Nasdaq 1000 and the small-cap Russell 2000 index.

In Chapter 3, "Holiday Seasonal Trends," we will look at the performance of the stock market around the major stock market holidays. We will first look at the day before each holiday and then at the combined performance of the two days prior to each holiday. Last, we will expand the test and consider the three trading days before and after each holiday. In subsequent chapters, we will combine this holiday trading information with other seasonal timing methods to create enhanced trading methods.

Monthly Trends

In Chapter 4, we will look at a variety of intramonth market trends. The objective will be to break down the trading month as much as possible into favorable and unfavorable trading days. Specifically, we will examine the data to determine whether there are certain days or blocks of contiguous days of the month that tend to perform better than others on a consistent basis. Also, in addition to identifying the single best trading day of the month, we will build on Norman Fosback's work and zero in on the most powerful times of the month to be invested in the stock market. Finally, we will examine the Santa Claus rally, and then incorporate all of the most powerful, consistent trends into one comprehensive model. The results are sure to surprise a great many individuals.

Yearly Trends

In Chapter 5, "Yearly Seasonal Trends," we will break the performance of the stock market down on the basis of yearly performance. Specifically, we will identify where each year falls within a given decade and then examine the data to determine whether there are any general trends based on year-of-decade proximity that can be useful to investors. Then we will look a little more closely at something known as the "decennial road map." This road map depicts the typical performance of the stock market over the

course of the average decade during the past century. As you will see, there are some definite repetitive trends that investors should look for as each decade progresses. Specifically, there are four separate trends that tend to play out within each given decade. We will examine the performance of the stock market on a decade-by-decade basis to highlight each of these trends and to identify how often each trend has occurred. We will then highlight how investors can use this information to maximize their profitability as each decade unfolds. Last, we will highlight three specific intradecade periods that have consistently been accompanied by great stock market strength. What we will ultimately find is that, by following the decennial road map and by investing aggressively during the favorable intradecade periods, an investor could have participated in the bulk of major bull markets over the past century while avoiding a great deal of the bearish activity over that same time frame.

Time Cycles of Note

In Chapter 6, “Time Cycles of Note,” we will focus on the performance of the stock market in relation to three specific and repetitive time cycles. We will first look at each cycle individually. As you will see, there are ways to use each cycle to identify favorable times to be in the stock market, as well as unfavorable times when an investor may do best to be out of the market. One thing to note regarding these cycles is that, as they are presented in this chapter, each cycle is of an exact length with no exceptions. This is noteworthy in that, nowadays, it is not uncommon to hear market analysts say things like, “The ten-week cycle is due to bottom out in the next several days.” In other words, it is suggested that there is something that is supposedly a ten-week cycle that may start anew in ten weeks, or ten weeks and one day, or ten weeks and two days, and so on. This type of analysis can become very subjective very quickly. So, what I want to accomplish in this book is to provide you with information on as many fully objective seasonal methods as possible and then allow you to judge them on their own merits using the data. At the end of Chapter 6, we will combine these three cycles into one comprehensive model and examine how we can use them in combination to generate some surprisingly profitable results.

There is one other important point that should be made regarding cycles such as those detailed in Chapter 6. Whatever the performance results may be for a given method, the goal is not to try to find the single best method and then use that method to the exclusivity of all others. Rather, the goal is to find a variety of methods that can be combined and that by so doing will give an investor the greatest likelihood of maximizing his or her profitability over the long run. The results in Chapter 6 will demonstrate one example of combining indicators that should not necessarily be used

as stand-alone systems, which when combined together can generate some very powerful and useful results.

Election Cycle Investing

Over the years, much analysis has been done and much has been written about the tendency for the stock market to make a major bottom. In addition, it has often been suggested that this cyclical tendency revolves around the presidential election that occurs once every four years in the United States. In Chapter 7, “Election Cycle Investing,” we will examine this phenomenon in great detail. We will start by looking at each of the four years that constitute the election cycle—postelection, midterm, preelection, and election year—separately to identify whether there are any broad trends that may give us clues as to where to search for the most favorable times to be in (and out of) the market. From there, we will build on the work of Dick Stoken, as mentioned earlier, and try to identify specific time periods within the 48-month election cycle that have consistently witnessed superior stock market performance. As it turns out, we are able to narrow down his original finding of a 15-month bullish phase just a bit (to 14 months) and then add another favorable 7-month period to identify 21 favorable months for investors within the context of each election cycle. As we will detail in Chapter 7, this 21-month favorable period within each election cycle has outperformed the 27 remaining months of each election cycle during 16 of the past 17 four-year election cycles. Investors who wish to invest aggressively when the odds are most in their favor will certainly want to be aware at all times of where the market is within this cycle.

In Chapter 7, we will also look at two much narrower time frames within the favorable periods that have tended to witness especially bullish market action over the years. And last, we will combine all of the information detailed throughout the chapter into one comprehensive model, the ultimate election cycle system.

Sell in May and Go Away

The title of Chapter 8—“Sell in May and Go Away”—has been a popular adage among stock market participants for many years. The notion that the stock market has performed much better during the six-month period starting in November versus the six months starting in May was first popularized by seasonal analysis founding father Yale Hirsch. In Chapter 8, we will analyze and update this theory in great detail. The idea of having a set time of each year to be in the market and a set time to be out of the market is an alluring one to many investors. If it were possible to maximize our profitability by simply making one round-turn trade every year—and

to make more money in the process than we might by using a simple buy-and-hold approach—this would, in theory, relieve a lot of concerns and would greatly reduce the amount of time, effort, and energy that we might otherwise feel compelled to exert on stock market analysis. So, is it really that simple? I will leave you to read Chapter 8 to decide for yourself.

In any event, after we thoroughly analyze the advantages and disadvantages of breaking the year into two six-month periods for investment purposes, we will then look at another method that has greatly improved on those initial results. This method involves applying a relatively simple market-timing method to the November to May method, as first popularized in *The Stock Trader's Almanac*. This is one of the few techniques detailed in this book that will actually require something more than a calendar to follow. However, because this minor modification has increased the profit generated during this time frame by a factor of 2.5 to 1 since 1950, it certainly appears to be worth the effort.

One other departure in Chapter 8 from the data that is analyzed throughout most of this book is an analysis of the action of the Nasdaq market from October through the following June. This time frame has tended to witness some very favorable price action—with several notable exceptions. So, we will take a closer look at the Nasdaq price action during this time frame and try to identify the potential benefits as well as the inherent risks. We will also apply the same simple market-timing method I mentioned a moment ago to this period of October to June in the Nasdaq method and measure the impact on the overall trading results there.

Last, in Chapter 8 we will also look at what I call the “dead zones.” In this chapter we will try to identify whether there are certain periods within the May through October period that are most likely to experience negative price action. Knowing when not to be in the market can sometimes be almost as useful as knowing when to be in the market, as this can allow an alert investor to act in advance to preserve capital until such time that the market turns favorable once again. We will examine the once-vaunted summer rally and take a very close look at both the action of the stock market during the month of September and an interesting—and potentially important— anomaly regarding the month of October.

SUMMING UP

The primary request that must be made of you, the reader, is that you consider the information contained in this book with an open mind. There is something in human nature that tends to cause people to be skeptical of anything that involves their money. Even more than that, there is also something in human nature that makes people skeptical of things that they do not understand or that cannot be explained logically. The fact of

the matter is that the majority of the trends, methods, cycles, and ideas contained in this book will likely fall into this category—hence the need for an open mind. Please remember that no one is going to try to convince you to adopt anything from this book and use it to the exclusion of all other methods. Probably the best way to get the most out of the material in this book is to approach it with the idea of trying to find ways to enhance and improve whatever investment methods you are presently using or are considering.

Ultimately, this book is about market timing. Market timing is another topic that elicits a great deal of skepticism among investors. However, there are two things to keep in mind here:

1. If your idea of market timing is picking tops and bottoms with uncanny accuracy, then you are right to be skeptical, because this simply does not happen. Regardless of the many claims to the contrary, no one always picks the tops and bottoms.
2. However, if your idea of market timing is trying to identify periods when the probabilities suggest that the stock market is more likely to advance than not, then you may eventually find the material in this book to be extremely useful.

Some of the techniques detailed in this book can be explained (at least to some extent), but many cannot. Therefore, you may find yourself at times facing a bit of a conundrum. On the one hand, you will find that some of the techniques detailed in this book have amazingly consistent track records. And the temptation to implement them in your own investment strategy may be great. At the same time, because there is no logical, rational explanation as to why some of these trends seem to exist and persist, there will also be doubt. No one ever set out with the goal of becoming a purely seasonal trader. Still, some of the seasonal trends that have existed over most or all of the past century are quite compelling. As a result, I am a strong proponent of using seasonal trends as part of an overall investment strategy.

All that being said, there is one caveat that I am compelled to mention—and that I will repeat often. Simply put, there is no guarantee that any of the seasonal trends detailed in this book will continue to work as well—or even at all—in the future as they have in the past. The purpose of writing this book is not to tell you what you should do, to reveal the hidden order in the stock market, or anything of the sort. The sole purpose is to enlighten you and to make you aware of some trends that you might not have been aware of up until now. I encourage you to take the time to absorb the information, review it, and then come to your own conclusions regarding its usefulness.

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