Two History-Based Strategies for Investing in 2010

In the 82-year history of the S&P 500 index since 1928, 25 years had their high in December and 14 of those years had their high after Christmas. 2009 was in both groups.

My analysis of both the 24 cases and the 13 cases prior to 2009 revealed patterns in the S&P 500 that could provide a desirable strategy for investing in 2010. I will consider two alternative strategies that compete with buying-and-holding the S&P 500. They are: (1) the January Barometer model and (2) the Wall Street Traffic Light model. The January Barometer model maintains that "As January goes, so goes the year." Mechanically, this means to stay in the S&P 500 throughout the year when January's change is positive, but to exit the S&P 500 during the February-through-December period when January's change is negative. The Wall Street Traffic Light (WSTL) model is explained in my book, *The Wall Street Traffic Light* (2006). A brief description of the model is given below.

January Barometer Model

Eighteen of the 24 December highs were followed by positive Januarys, and the average return for those years was 17.2%. Six of the 24 were followed by negative Januarys, and the average return for those years was −3.5%. By incorporating the effect of not owning the S&P 500 for the February-through-December period, the average annual return for the years having negative Januarys was 0.8%. As a result, the overall average annual return for the 24 years using the January Barometer model was 13.1%. In regard to risk, three of the years had negative returns: −7.4%, −8.1% and −9.7%. **The details of the 24 cases are in Table 1 below.**

Table 1

When the Year's High Occurred in December, What Was the Following Year's Return?

This table is based on S&P 500 data, 1928-2009
(Daily values were first published in 1928.)

		The Following Year					
Case	Date of Year's High Was in December	Year	January Change	Annual Return if Jan. Positive	Annual Return if Jan. Negative	Annual Return If in Cash Feb.-Dec.*	Overall Annual Return
1	12/31/42	1943	7.2%	25.9%			25.9%
2	12/16/44	1945	1.4%	36.4%			36.4%
3	12/10/45	1946	7.0%	-8.1%			-8.1%
4	12/30/49	1950	1.7%	31.7%			31.7%
5	12/29/50	1951	6.1%	24.0%			24.0%
6	12/30/52	1953	-0.7%		-1.0%	0.3%	0.3%
7	12/31/54	1955	1.8%	31.6%			31.6%
8	12/31/58	1959	0.4%	12.0%			12.0%
9	12/12/61	1962	-3.8%		-8.7%	4.9%	4.9%
10	12/31/63	1964	2.7%	16.5%			16.5%
11	12/11/72	1973	-1.7%		-14.7%	13.0%	13.0%
12	12/16/85	1986	0.2%	18.5%			18.5%
13	12/02/86	1987	13.2%	5.2%			5.2%
14	12/31/91	1992	-2.0%		7.7%	-9.7%	-9.7%
15	12/18/92	1993	0.7%	10.0%			10.0%
16	12/28/93	1994	3.3%	1.3%			1.3%
17	12/13/95	1996	3.3%	23.1%			23.1%
18	12/05/97	1998	1.0%	28.6%			28.6%
19	12/29/98	1999	4.1%	21.0%			21.0%
20	12/31/99	2000	-5.1%		-9.1%	4.0%	4.0%
21	12/31/03	2004	1.7%	10.9%			10.9%
22	12/30/04	2005	-2.5%		4.9%	-7.4%	-7.4%
23	12/14/05	2006	2.5%	15.8%			15.8%
24	12/15/06	2007	1.4%	5.5%			5.5%
25	12/28/09	2010					
	Mean			17.2%	-3.5%	0.8%	13.1%

* Ignores interest that would have been earned during the February-through-December period.

The prior 13 years that had a post-Christmas high were followed by nine positive Januarys, and the average return for those years was 19.4%. For the four years followed by negative Januarys, the average return was 0.6%. By incorporating the effect of not owning the S&P 500 for the February-through-December period, the average annual return for the years having negative Januarys was −3.2%. As a result, the overall average annual return for the 13 years using the January Barometer model was 12.5%. In regard to risk, two of the years had negative returns: 7.4% and 9.7%. **The details of the 13 cases are in Table 2 below.**

Table 2

When the Year's High Occurred in After Christmas, What Was the Following Year's Return?

			The Following Year				
Case	Date of Year's High Was After Christmas	Year	January Change	Annual Return if Jan. Positive	Annual Return if Jan. Negative	Annual Return If in Cash Feb.-Dec.*	Overall Annual Return
1	12/31/42	1943	7.2%	25.9%			25.9%
2	12/30/49	1950	1.7%	31.7%			31.7%
3	12/29/50	1951	6.1%	24.0%			24.0%
4	12/30/52	1953	-0.7%		-1.0%	0.3%	0.3%
5	12/31/54	1955	1.8%	31.6%			31.6%
6	12/31/58	1959	0.4%	12.0%			12.0%
7	12/31/63	1964	2.7%	16.5%			16.5%
8	12/31/91	1992	-2.0%		7.7%	-9.7%	-9.7%
9	12/28/93	1994	3.3%	1.3%			1.3%
10	12/29/98	1999	4.1%	21.0%			21.0%
11	12/31/99	2000	-5.1%		-9.1%	4.0%	4.0%
12	12/31/03	2004	1.7%	10.9%			10.9%
13	12/30/04	2005	-2.5%		4.9%	-7.4%	-7.4%
14	12/28/09	2010					
	Mean			19.4%	0.6%	-3.2%	12.5%

* Ignores interest that would have been earned during the February-through-December period.

Wall Street Traffic Light (WSTL) Model

The WSTL model, which was derived from 35 years of the S&P 500's history, involves infrequent market timing. Here's how the model works. During the January-through-April period each year, the model classifies the year into one of seven categories: 1A, 1B, 1C, Tier 2, 3A, 3B or 3C. The strategy of buying-and-holding the S&P 500 is used throughout 1A, Tier 2 and 3A years. For 1B, 1C, 3B and 3C years, there is one round-trip trade out of the S&P 500 during the first four months of the year and then back into the S&P 500 later in the year. A complete explanation about the criteria for the trades is in my book, pp. 13-19.

The 24 years having December highs were classified as follows (the 18 buy-and-hold years are in **bold blue**):

Type of Year	Number of Years
1A	**11**
1B	1
1C	5
Tier 2	**5**
3A	**2**
3B	-
3C	-
Total	24

Only six trades occurred in the 24 years: one in a 1B year and five in 1C years.

The average annual return for the 24 years using the WSTL model was 14.4%. In regard to risk, two of the years had negative returns: 0.2% and 3.0%. **The details of the 24 cases are in Table 3 below.**

Table 3

Applying the Wall Street Traffic Light (WSTL) Model to the 24 Prior December Cases:

When the Year's High Occurred in December, What Was the Following Year's Return?

		The Following Year			
Case	Year	S&P 500 Return Under Buy-and-Hold	Type of Year Under WSTL Model	Outcome of WSTL Trade	WSTL Return
(1)	(2)	(3)	(4)	(5)	(6) = (3) + (5)
1	1943	25.9%	3A		25.9%
2	1945	36.4%	1A		36.4%
3	1946	-8.1%	1B	9.4%	1.3%
4	1950	31.7%	Tier 2		31.7%
5	1951	24.0%	1A		24.0%
6	1953	-1.0%	1C	9.5%	8.5%
7	1955	31.6%	1A		31.6%
8	1959	12.0%	1A		12.0%
9	1962	-8.7%	1C	11.0%	2.3%
10	1964	16.5%	Tier 2		16.5%
11	1973	-14.7%	1C	11.7%	-3.0%
12	1986	18.5%	1A		18.5%
13	1987	5.2%	1A		5.2%
14	1992	7.7%	1A		7.7%
15	1993	10.0%	1A		10.0%
16	1994	1.3%	Tier 2		1.3%
17	1996	23.1%	1A		23.1%
18	1998	28.6%	1A		28.6%
19	1999	21.0%	1A		21.0%
20	2000	-9.1%	1C	9.2%	0.1%
21	2004	10.9%	3A		10.9%
22	2005	4.9%	1C	-5.1%	-0.2%
23	2006	15.8%	Tier 2		15.8%
24	2007	5.5%	Tier 2		5.5%
25	2010				
Mean		12.0%		7.6%	13.9%

For the 13 post-Christmas cases, the average annual return using the WSTL model was 14.7%. In regard to risk, only one of the years had a negative return: 0.2%. **The**

details of the 13 cases are in Table 4 below. ***My conclusion regarding this research follows Table 4.***

Table 4

Applying the Wall Street Traffic Light (WSTL) Model to the 13 Prior Post-Christmas Cases:
When the Year's High Occurred in After Christmas, What Was the Following Year's Return?

		The Following Year			
Case	Year	S&P 500 Return Under Buy-and-Hold	Type of Year Under WSTL Model	Outcome of WSTL Trade	WSTL Return
(1)	(2)	(3)	(4)	(5)	(6) = (3) + (5)
1	1943	25.9%	3A		25.9%
2	1950	31.7%	Tier 2		31.7%
3	1951	24.0%	1A		24.0%
4	1953	-1.0%	1C	9.5%	8.5%
5	1955	31.6%	1A		31.6%
6	1959	12.0%	1A		12.0%
7	1964	16.5%	Tier 2		16.5%
8	1992	7.7%	1A		7.7%
9	1994	1.3%	Tier 2		1.3%
10	1999	21.0%	1A		21.0%
11	2000	-9.1%	1C	9.2%	0.1%
12	2004	10.9%	3A		10.9%
13	2005	4.9%	1C	-5.1%	-0.2%
14	2010				
Mean		13.6%		4.5%	14.7%

Conclusion

Here is a summary of the average annual returns from my research:

	Average Annual Return			
	Model	Buy-and-Hold S&P 500	Effect of Using Model	Years Having Negative Returns
24 December Cases				
January Barometer	13.1%	12.0%	1.1%	3 years: −7.4%, −8.1%, −9.7%
WSTL	13.9%	12.0%	1.9%	2 years: −0.2%, −3.0%
Advantage of WSTL	0.8%		0.8%	
13 Post-Christmas Cases				
January Barometer	12.5%	13.6%	−1.1%	2 years: −7.4%, −9.7%
WSTL	14.7%	13.6%	1.1%	1 year: −0.2%
Advantage of WSTL	2.2%		2.2%	

For the 24 December cases, both models beat buying-and-holding the S&P 500, but the WSTL had an average annual advantage over the January Barometer of 0.8%. For the 13 post-Christmas cases, only the WSTL beat buy-and-hold. The WSTL had an average annual advantage over buy-and-hold of 1.1%. Moreover, the WSTL had a very low risk as measured by years having negative returns.

Given that the S&P 500 reached its 2009's high after Christmas, my historical analysis indicates that applying the WSTL model (rather than the January Barometer model) in 2010 could be prudent, particularly for risk-averse investors.

For updates on the WSTL model's performance in recent years, click on the "Market Commentaries" button on this Website.

Happy New Year,

John K. Harris

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