MDP ASSOCIATES LLC

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January Barometer Revisited

In a way, this edition is a follow up to the one early this month about the predictive power of the first trading day of the year and the first five days. You may have read or heard that this month was the worst January ever for the Dow and S&P 500 and that the "January Barometer" has been quite accurate (the *Washington Post* story said 87% over the past 30 years) in forecasting the direction of stock prices for the rest of the year. I'll take a quick look at what happens after a particularly bad January like this year's.

(As a follow up to the previous interim newsletter, the S&P gave up most of the gains of the first day, but was up almost three-quarters of a percent after the first five trading days of 2009. That put it in the middle range of my analysis, which has been followed by a rest of the year that was neither particularly good nor bad on the average.)

I have discussed the so-called January Barometer several times. (The most complete discussion, from four years ago, is on my web site: www.pankin.com/persp044.pdf) In short, it says that if stocks are up in January, the rest of the year and the next 12 months are likely to be a good time to own stocks. Down Januaries are followed by mixed results.

I have monthly S&P 500 data going back to 1940. Since then, not counting this year, there have been 30 times when the S&P had finished January lower than the end of the prior year. In 16, 53%, of the following February-December periods, the index gained. However, the average for the 30 times was a loss of about 1.3%, a large part of that being due to last year's drop of 35.5% in the last eleven months. The barometer is not very predictive when January is a down month. Its real strength is that an up January is a very good sign for stocks for the rest of the year.

What about the worst Januarys? This year's drop was 8.6%, the worst ever. There have been five other times when the S&P fell by more than 6% in the first month of the year, and the next worst on the list was under 5%, so we can consider those five as the best "matches" for 2009. However, the standard

warnings about drawing inferences from such a small amount of data certainly apply here. Consider what follows primarily for amusement.

The five years were 1970 (-7.8% in January, +6.3% the rest of the year), 1981 (-6.9%, -3.3%), 1990 (-6.9%, +0.3%), 1960 (-6.6%, +2.9%), and 2008 (-6.1%, -35.5%). So three of the five years saw gains, but last year's loss would pull the average of the five down to well over five percent. I don't think being down a lot in January tells us any more than just being down. While last year's plunge might suggest a particularly bad first month could raise a special warning flag, two other downers were followed by losses of over 20% for the rest of the year, and another four saw drops of over 10%.

As I have written before, I am not a fan of calendar based methods, so the drop in January won't have any effect on how I mange accounts. When it comes to taking positions in broad based market indices such as the S&P, usually by buying an index fund, I am a trend follower. I have a couple quantitative models that I use to evaluate the current several month or longer trend in stock prices, and I make trading decisions based on the readings of these models. Like all other methods, they are far from perfect, but they do a great job of avoiding severe down periods like the last half of 2008 and a very good job of capturing a nice portion of moves up in stock prices. The models currently are not at all close to saying it is time to get back into stocks.

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