

The Summer Doldrums

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A few months ago I wrote about “The Dead Zone,” a name that describes the typical market performance during the summer months. I noted that, according to Allan Newman, an initial investment of \$10,000 in the stocks included in Dow Jones Industrial Average index (DJIA) invested between November 1st and April 30th since 1950, would have grown to \$487,322. By contrast, an initial investment of \$10,000 in stocks included in the DJIA each year on May 1st and sold on October 31st since 1950, grew to a mere \$10,431 over the same time period. This strategy of investing in the favorable period of the year also outperformed the buy and hold investor as well. (The Dow Jones Industrial Average (DJIA) is the most widely used indicator of the overall condition of the U.S. [stock market](#), a price-weighted average of 30 actively traded [blue chip stocks](#), primarily industrials.)

So here we are today, roughly half way through the Dead Zone and the stock indices have not rallied “into the election,” as was expected by so many.. If I had a dollar for every time I heard someone say that the markets would rally into the election, well, you know the rest.

So why does the stock market tend to perform better during the November to April time frame? Well, it seems that the market seasonal tendencies have nothing to do with politics or economics. According to Sy Harding, publisher of the Street Smart Report, seasonality is created by the extra chunks of money that flow into investors’ hands beginning in the fall, much of which finds its way into the stock market, driving it higher. The sources of that extra money dry up in the spring, choking off the market from that extra fuel which leaves it vulnerable to selling pressure due to economic concerns, terrorism or other influential events.

Sy Harding notes that those extra chunks of money come from mutual fund distributions in November and December, Christmas bonuses, year-end and profit-sharing bonuses, employer’s year-end contributions to their employees 401(k) and pension plans, year-end corporate dividends, income tax refunds, and the like. That money comes to the market whether we are at war or at peace, whether interest rates are rising or declining, or whether the economy is booming or slowing. Remember 1998, when the S&P 500 index was up 28% for the year, one of the best performances of the 90’s, but between July and October the S&P 500 declined 19%. During that year, an investor’s awareness of market seasonality may have helped him avoid losses during the period of seasonal weakness.

Even bear market rallies usually take place during the market’s favorable season. Consider the rally that began two weeks after the 9/11 terrorist attacks. Even such a devastating blow to investors’ psyche could not keep the S&P 500 index from rising 22% and the Nasdaq from rising 35% in their subsequent favorable season.

So what drives the price of stocks higher? In my opinion it’s just plain old supply and demand. The flow of money into stocks has been greater, on average, from November to May, going back to 1950, than at other times of the year, producing the bulk of each year’s returns. Looking back at 2003, you might conclude that even during the summer months the stock market can perform reasonably well.

For a moment, let's reflect back on what was driving stock prices higher in 2003. Was it the war with Iraq? Was it the high oil prices? Was it that the economy was still not recovering, or that the number of laid-off workers was expanding, in spite of the numerous rate cuts? Regardless of all the negative news, and after trading flat to slightly down during July to August, the markets marched higher for the remainder of the unfavorable season. Why? In my opinion it was because Washington initiated the most aggressive economic stimulus package in history, with tax cuts, tax rebates, child-care bonuses, low interest rates to stimulate home-mortgage refinancing, all with the goal of putting extra chunks of money in people's hands during the usually slow summer months. And since most of the tax cuts went to the wealthy, the way the government defines wealthy, not the way you or I might define wealthy, much of the money found its way into the stock market.

Many dismiss the existence of market seasonality, but with the market's inability to rally into the presidential election as many had predicted, the examples we've discussed provide some evidence that seasonality may exist.

Past performance does not guarantee future results. The indices represent market sectors that may have different risks. Small-cap stocks may be more volatile than mid-cap and large-cap stocks. The performance information does not show the effects of income taxes on an individual's investment. Taxes may reduce your actual investment returns or any gains you may realize if you sell your investment. One may not directly invest in an index.)