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TOUCHBUTTON

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The January effect, US Presidential cycles and how to predict what will happen in 2012

The pundits have had their say, and the new year papers are in the recycling bin. Last year, most investment commentators expected 2011 to be a good year for equity markets, with virtually every major investment house predicting rises in values. We all know what happened: world markets fell by 5.8%, but this disguised falls of 11.4% for mainland Europe, and 15.5% for Asia excluding Japan. The UK FTSE All Share Index fell by 3.5%, but the US S&P 500 was virtually unchanged.

So what are the experts saying for this year? Broadly the same actually, which at least says something for consistency of message.

But if you want to ignore some of the professionals, consider the January barometer, which was devised by one Yale Hirsch in 1972. The idea is that as the S&P 500 Index fares for January, so goes the rest of the year. Does it work? In the period from 1950 to 2000, if the market rose in the calendar month of January, it went on to post a positive return for the year as a whole in just over 90% of years, which is not a bad record. Since then, it's been wrong only once – in 2001, when the S&P 500 increased by 3.5% in the month of January, but went on to post a full year decline of 13%. So far in this January, the S&P 500 is up just over 5%.

If you prefer a more political angle, consider the Presidential cycle. US election years have been generally good ones since around 1948, with the notable exception of 2008, which was of course terrible, when the banking crisis and collapsing housing market conspired to produce the worst year for the Dow Jones since 1931. Since 1901, however, the average election year gain has been 7.5%, with 18 up years and 9 down years.

For further encouragement, solid gains usually follow flat years. The roller coaster of 2011 actually ended up all square in the US, with the S&P 500 just a fraction of a point lower. Since 1930, there have been eleven years when the S&P was flat – including 2011. In eight of the following ten, the index went on to post a full year gain, with a happy average gain of 17.9%. Let's see how that eleventh year progresses.

Sources: Morningstar, Stock Trader's Almanac. All indices in local currency.