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January Almanac: Top Month for Stocks in Pre-Election Years

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January has quite a legendary reputation on Wall Street as an influx of cash from yearend bonuses and annual allocations typically propels stocks higher. January ranks #1 for NASDAQ (since 1971), but sixth on the S&P 500 and DJIA since 1950. It is the end of the best three-month span and holds a full docket of indicators and seasonalities.

DJIA and S&P rankings did slip from 2000 to 2018 as both indices suffered losses in ten of those nineteen Januarys with three in a row, 2008, 2009 and 2010. January 2009 has the dubious honor of being the worst January on record for DJIA (-8.8%) and S&P 500 (-8.6%) since 1901 and 1931 respectively. Despite late-month weakness in 2018, S&P 500 still gained 5.6% and DJIA jumped 5.8%.

In pre-election years, Januarys have been downright stellar ranking #1 for S&P 500 and NASDAQ and #2 for DJIA. Average gains range from 3.7% on DJIA to a whopping 6.6% for NASDAQ.

Inside

On pages 108 and 110 of the *Stock Trader's Almanac 2019* we illustrate that the January Effect, where small caps begin to outperform large caps, actually starts in mid-December. Thus far, signs of this have been absent when comparing Russell 2000 to S&P 500 as broad weakness up to Christmas Eve depressed most shares. The majority of small-cap outperformance is normally done by mid-February, but strength can last until mid-May when indices typically reach a seasonal high.

The first indicator to register a reading in January is the *Santa Claus Rally*. The seven-trading day period began on the open on December 24 and ends with the close of trading on January 3. Normally, the S&P 500 posts an average gain of 1.3%. The failure of stocks to rally during this time tends

January Vital Stats (1950-2017)	DJIA	S&P 500	NASDAQ
Rank[2]	6	6	1
# Up	44	42	31
# Down	25	27	17
Average %	0.9	1.0	2.7
4-Year Presidential Election Cycle Performance by %			
Post-Election	0.6	0.8	2.3
Mid-Term	–0.5	–0.7	0.01
Pre-Election	3.7	3.9	6.6
Election	–0.01	0.2	1.7
Best & Worst January by %			
Best	1976 14.4	1987 13.2	1975 16.6
Worst	2009 –8.8	2009 –8.6	2008 –9.9
January Weeks by %			
Best	1/9/1976 6.1	1/2/2009 6.8	1/12/2001 9.1
Worst	1/8/2016 –6.2	1/8/2016 –6.0	1/28/2000 –8.2
January Days by %			
Best	1/17/1991 4.6	1/3/2001 5.0	1/3/2001 14.2
Worst	1/8/1988 –6.9	1/8/1988 –6.8	1/2/2001 –7.2
January 2018 Bullish Days: Data 1997-2017			
	2, 3, 25, 28	10, 16, 25	2, 8-10, 16, 28
January 2018 Bearish Days: Data 1997-2017			
	8, 17, 18, 22	None	15, 18, 22

[2] *Based upon the average historical monthly performance of the indices in comparison to other months of the year.*
[3] *Based on the S&P 500 Rising 60% or more of the time on a particular trading day.*
[4] *Based on the S&P 500 Falling 60% or more of the time on a particular trading day.*

(continued on page 2)

January Almanac: Top Month for Stocks in Pre-Election Years

(continued from page 1)

to precede bear markets or times when stocks could be purchased at lower prices later in the year.

On January 8, our First Five Days "Early Warning" System will be in. In pre-presidential election years this indicator has a solid record. In the last 17 pre-presidential election years 12 full years followed the direction of the First Five Days. 1955, 1991, 2007, 2011 and 2015 did not. The full-month January Barometer has an even better pre-presidential-election-year record as 15 of the last 17 full years have followed January's direction.

Our flagship indicator, the January Barometer created by Yale Hirsch in 1972, simply states that as the S&P goes in January so goes the year. It came into effect in 1934 after the Twentieth Amendment moved the date that new Congresses convene to the first week of January and Presidential inaugurations to January 20.

Pre-Election Year January since 1950

	Rank[1]	Avg %	Up	Down
DJIA	2	3.7	15	2
S&P 500	1	3.9	15	2
NASDAQ*	1	6.6	10	2

[1] *Based upon the average historical monthly performance of the indices in comparison to other months of the year.*

** Since 1971*

The long-term record has been stupendous, an 86.8% accuracy rate, with only nine major errors in 68 years. Major errors occurred in the secular bear market years of 1966, 1968, 1982, 2001, 2003, 2009, 2010 and 2014 and again in 2016 as a mini bear came to an end. The market's position on January 31 will give us a good read on the year to come. When all three of these indicators are in agreement it has been prudent to heed their call.

2019 Forecast: Santa on Notice from Dueling Grinches – Low Nears – Bear Lurks

Fed Chairman Powell and President Trump have been competing for who can freak the market out most. Our contention for months has been that the Fed is the biggest risk to the market and economy and that surely seems to have come home to roost the past few months.

Last month in our "Market at a Glance" we said that, *"After nearly a decade at zero, a brief pause to evaluate the impact of recent hikes does not seem unreasonable."* In addition to the continuing rate hikes is the impact of the Fed's quantitative tightening program of reducing its balance sheet, which is equivalent to another 1/4 or 1/2 point on the Fed Funds rate. We have not been the only ones saying this and perhaps Stanley Druckenmiller said it best in his *Wall Street Journal* piece in mid-December.

And in the face of this market selloff Chairman Powell refused to relent and pause to reflect. Perhaps he's playing hardball with President Trump and wants to prove the Fed's independence or perhaps he is just determined to raise rates as much as he can while the "labor market has continued to strengthen and" "economic activity has been rising at a strong rate," in the Fed's own words from the 12/19/18 FOMC Statement.

Either way his comments at his news conference that he expects to raise rates 2 more times in 2019, while the Fed's growth forecasts for 2019 and beyond are for slower growth were not what the market wanted to here. Quarter point now and a pause to reflect would have been music to Wall Street's ears.

President Trump's own games of hardball with the Democrats over the "wall" and the funding bill to reopen the federal government open and the Chinese over fair trade spooked the market through most of Q4 2018. The market's performance in Q4 was the exact opposite of historical averages. Higher interest rates, trade disputes and Brexit all appear to be weighing on the market. Tougher corporate earnings comparisons and slowing earnings growth are also hindering the market.

Technically the market is broken. As we warned on our blog December 17 we were flirting with disaster and

(continued on page 3)

2019 Forecast: Santa on Notice from Dueling Grinches – Low Nears – Bear Lurks

(continued from page 2)

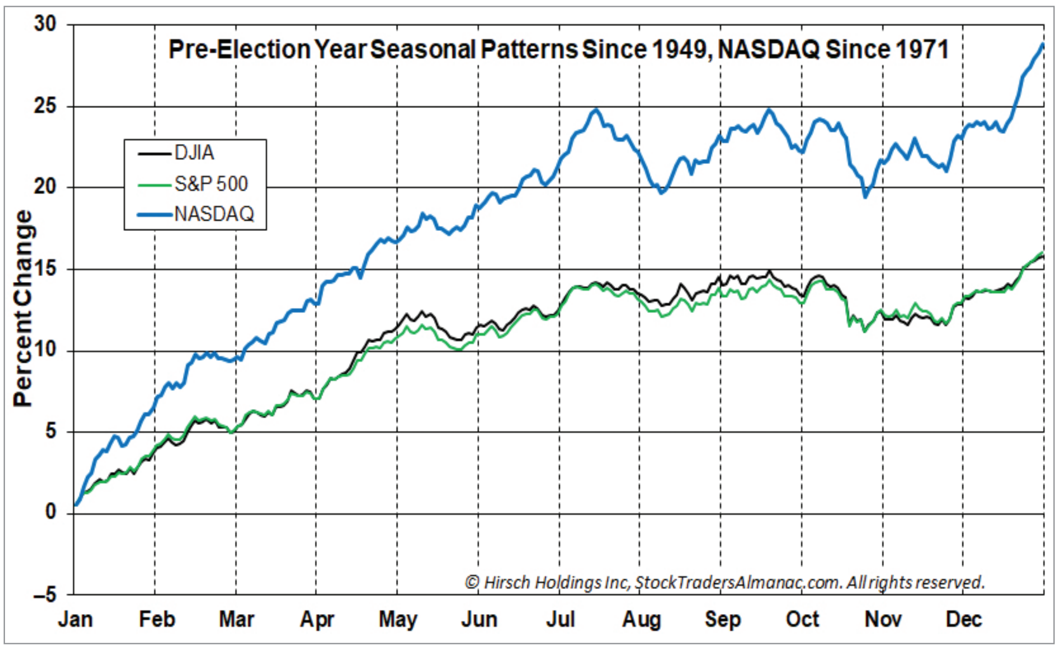
when all three major U.S. market indices violated the early 2018 lows more selling ensued as there was little support below them. For now we seem to have found support way back at the August 2017 lows around Dow 21700, S&P 2425 and NASDAQ 6200.

If the U.S.-China trade negotiations move in a positive direction, the Fed tones down some of its more hawkish rhetoric and the federal government reopens with Dems and Reps working together more the market will be free to rally and bring the "official" Santa Claus Rally to Wall Street. So as we wind down this year of the return to volatility and more historically normal market action (2017 was an anomaly) our outlook is tempered, at least into early 2019. If our Santa Claus Rally can materialize that would be the first constructive sign, if not, we would expect more volatility.

Midterm Correction Sets Stage

The tax cut legislation held off the usual midterm year correction until much later in the year, pushing the potential low toward yearend and into 2019. But this bodes well for pre-election year 2019. If the market had kept chugging along to new highs, gains in 2019 would have been harder to come by.

Now that we have a sizeable correction



(continued on page 4)

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Midterm Correction Sets Stage

(continued from page 3)

and maybe a bit more downside in store, 2019 is setting up better than it was at the beginning of October. If the market has found support here or early in 2019, the Fed comes to its senses and the folks in D.C. can cut some deals more normal pre-election year gains can be expected.

The third year of the 4-year presidential election cycle is still the strongest and now with the market hitting new 52-week lows the stage is set. For perspective have a look at the average 1-year seasonal patterns for the Dow, S&P 500 and NASDAQ in the chart on page 3.

2019 Forecast

There is an increasing probability that we are in a bear market right now in the U.S. And if the U.S. market continues to behave as it has for the last few months, we could be down 20% on the Dow and S&P 500 in early 2019. The NASDAQ was down 23.6% on a closing basis at the 12/24/2018 close and S&P 500 was down 20% intraday from its high.

Taking into account the risks of heightened volatility, increasingly bearish sentiment, a more tepid fundamental outlook, a persistently hawkish Fed, an embattled Federal government as well as the bullish history of pre-election year markets and historical seasonal patterns we have once again laid out three scenarios for 2019:

- **Worst Case** – Prolonged bear market caused by hawkish Fed, dysfunctional Federal Government, slow growth and weak corporate fundamentals brings us all the way back to November 2016 pre-Trump election levels or lower. Repeat of pre-election year 2015 with the bear lasting throughout 2019 into 2020.
- **Base Case** – Something gives. Mild bear market bottoms soon or in early 2019 as Fed tones down rhetoric and holds off raising rates, Trump and the Dems work out a few deals and we have modest pre-election year gains in the 5-10% range.
- **Best Case** – Everything resolves quickly. Fed becomes accommodative. Trade deals are worked out expeditiously. Trump tacks towards the center and works with congress and does not get "*Muellered.*" Typical pre-election year gains of 10-15% for Dow and S&P 500 and 20-30% for NASDAQ

We will be keeping you fully abreast of all readings from out three January Trifecta Indicators: Santa Claus Rally, First Five Days and the full-month January Barometer and will make adjustments on the close of January 2019.

Happy Holidays & Happy New Year, we wish you all a healthy and prosperous 2019!

Index Definitions: The S&P 500 Index is an unmanaged composite of 500 large capitalization companies. This index is widely used by professional investors as a performance benchmark for large-cap stocks. The Dow Jones Industrial Average ('DJIA') is an unmanaged composite of 30 widely held stocks. The NASDAQ Index is an unmanaged composite of the common stocks and similar securities listed on the NASDAQ Stock Market. The Russell 2000 Index is an unmanaged composite of the bottom 2,000 stocks in the Russell 3000 Index. The Russell 3000 Index is an unmanaged composite of the 3,000 largest publicly held companies incorporated in America as measured by total market capitalization. The Russell 2000 index is widely used by professional investors as a performance benchmark for small-cap stocks.You cannot invest directly in an index and unmanaged index returns do not reflect any fees, expenses or sales charges. Past performance does not guarantee future results.

Market at a Glance

Seasonal: *Bullish.* January is the third month of the Best Six/Eight, but it is the last of the Best-Three-Consecutive-month span. January is the top month for NASDAQ (since 1971) averaging 2.6%, but it has slipped to sixth for DJIA and S&P 500 since 1950. Pre-election-year Januarys have been exceptional (DJIA +3.7%, S&P 500 +3.9% NASDAQ +6.6%). The Santa Claus Rally ends on January 3rd and the First Five Days early-warning system ends on the 8th. Both indicators provide an early indication of what to expect in 2019. We will wait until the official results of the January Barometer on January 31 before tweaking our 2019 Annual Forecast.

Psychological: *Neutral.* According to *Investor's Intelligence* Advisors Sentiment survey bulls are at 39.3%. Correction advisors are at 39.3% and Bearish advisors are 21.4%. At current levels, sentiment is essentially flat. Bearish advisors have ticked modestly higher but are still just a few percentage points above their level when the market was at all-time highs a few months ago.

Fundamental: *Firm-ish.* Near-term the outlook remains reasonably solid. Unemployment is low, the economy is still creating jobs each month, corporate earnings, although slowing, are forecast to continue growing and Atlanta Fed's *GDPNow* model is forecasting 2.9% growth for Q4. Beyond the near-term the outlook becomes murky. The housing market and the auto industry are feeling the bite of higher interest rates already. Foreign markets are struggling, more tariffs could be coming, and the Fed has forecast a slowdown in growth in 2019 and 2020. One may want to consider that the Fed does not have the greatest track record forecasting growth and it has admitted such.

Technical: *Broken down.* DJIA, S&P 500 and NASDAQ have all closed below support at their respective lows from earlier this year. Death crosses appear on the charts of all four. Russell 2000 is in the worst shape down over 27% since its high to officially be in a bear market. Dow Theory is also signaling the possibility of a new bear market, but utilities have not broken down yet. Technical indicators applied to the major indexes are near or at oversold levels.

"DJIA, S&P 500 and NASDAQ have all closed below support at their respective lows from earlier this year. Death crosses appear on the charts of all four. Technical indicators applied to the major indexes are near or at oversold levels....The Fed did take a somewhat less hawkish tone at its recent meeting, but it apparently was not dovish enough....Even a moderately hawkish Fed is still the greatest risk to the economy and the market. The continued flattening of the Treasury yield curve is the market signaling to the Fed it is time to pause and even consider easing up a bit."

Monetary: *2.25-2.50%.* The Fed did take a somewhat less hawkish tone at its recent meeting, but it apparently was not dovish enough. After raising interest rates for the fourth time this year, the Fed suggested fewer hikes will occur next year which was a mild win for the bulls. However, the Fed failed to mention any possibility of slowing the rate at which is reducing its balance sheet. In the end only the slightest of shifts away from its previously hawkish tightening monetary policy. Even a moderately hawkish Fed is still the greatest risk to the economy and the market. The continued flattening of the Treasury yield curve is the market signaling to the Fed it is time to pause and even consider easing up a bit.

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