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January Almanac: Indicator Trifecta Could Reshape 2022

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January has quite a reputation on Wall Street as an influx of cash from year-end bonuses and annual allocations has historically propelled stocks higher. January ranks #1 for NASDAQ (since 1971), but fifth on the S&P 500 and DJIA since 1950. January is the last month 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 2016 as both indices suffered losses in ten of those seventeen Januarys with three in a row, 2008, 2009 and 2010 and then again from 2014 to 2016. 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 1930 respectively. The early stages of the Covid-19 pandemic spoiled January in 2020 & 2021 as DJIA, S&P 500 and Russell 2000 all suffered declines in 2020. In 2021, DJIA and S&P 500 declined.

In midterm years, January ranks near the bottom since 1950. Large-caps have been the worst with S&P 500 ranking #10 (third worst) and DJIA ranking #9. Technology and small-cap shares fare slightly better in the rankings, but small-cap average performance is still negative and NASDAQ is only barely positive.

On pages 112 and 114 of the *Stock Trader's Almanac 2022* we illustrate that the January Effect, where small caps begin to outperform large caps, actually tends to start in mid-December. Early signs of the January Effect can be seen when comparing the Russell 2000 to the S&P 500 since around December 15. Historically, 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 27 and ends with the close of

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Midterm Year January since 1950

	Rank[1]	Avg %	Up	Down
DJIA	9	–0.5	9	9
S&P 500	10	–0.7	9	9
NASDAQ*	5	0.01	6	6

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

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January Vital Stats (1950-2021)

	DJIA		S&P 500		NASDAQ	
Rank[2]	5		5		1	
# Up	45		43		34	
# Down	27		29		17	
Average %	0.9		1.1		2.8	
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	3.9		4.1		6.8	
Election	–0.1		0.1		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	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 2021 Bullish Days[3]: Data 2000-2021						
	3, 4		5, 10, 11, 18, 25		3, 7, 10, 11, 18 24, 26	
January 2021 Bearish Days[4]: Data 2000-2021						
	7, 21		None		14	

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[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.*

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trading on January 4. Normally, the S&P 500 posts an average gain of 1.3%. The failure of stocks to rally during this time has tended to precede bear markets or times when stocks could be purchased at lower prices later in the year.

On January 7, our First Five Days "Early Warning" System will be in. In midterm election years this indicator has a poor record. In the last 18 midterm election years 8 full years followed the direction of the First Five Days. The full-month January Barometer has a slightly better record in midterm election years with 10 of the last 18 full years following 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.

The long-term record has been stupendous, an 84.5% accuracy rate, with only 11 major errors since 1950. 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 tenth major was in 2018 as a hawkish Fed continued to hike rates even as economic growth slowed and longer-term interest rates fell. Historical levels of support from the Fed and Federal governments in 2020 quickly undid the market damage caused by the Covid induced economic shutdown. Currently, 2021 will be the 12th major error for the January Barometer. The market's position on the last trading day of January will give us a better read on the year to come. When all three of these indicators are in agreement it has been prudent to heed their call.

2022 Forecast: Early Year High, Worst Six Months Correction & Q4 Rally

As we laid out in our 2021 Forecast Best Case scenario last year Covid-19 vaccines rolled out rather well in 2021 allowing lockdowns and most restrictions to be removed. Additional fiscal stimulus and an extremely accommodative Fed kept the economy humming and the market rallying. Unemployment dove from the early pandemic peak rather precipitously. Leisure, hospitality and travel did not surge per se, but they sure did rebound. The market is on pace to deliver our Best Case scenarios for 2021. With three trading days left in 2021 DJIA is up 18.9% year-to-date, S&P 500 is up 27.4% and NASDAQ is up 22.5%.

Omicron, inflation and the Fed's tapering of its accommodative asset purchase program have been giving the market jitters the past few months and creating some volatility. At the last FOMC meeting the Fed came clean on inflation being more persistent, but they also remained rather dovish, reiterating their measured pace of tapering asset purchases and patience with raising rates. This flexibility and reassurance that they are keen on curtailing rampant inflation while remaining supportive of the tentative economic outlook in the face of the enduring pandemic was bullish for Wall Street.

We anticipate the results of the Santa Claus Rally to help solidify our outlook for next year. The Santa Claus Rally was defined by Yale Hirsch in 1972 as the last five trading days of the year and the first two trading days of the New Year. S&P 500 averages 1.3% over the 7-day period, but the real importance of the SCR is as our first seasonal indicator of the year ahead. As the late, great Yale Hirsch's famous line states, *"If Santa Claus should fail to call, bears may come to Broad and Wall."*

The market faces several obstacles for next year. Valuations are rich and year-over-year economic and corporate comparisons will be nowhere near as easy as 2021 versus the 2020 pandemic numbers. While the Fed has promised patience and a slow pace it is now rather clear that they will be making a concerted effort to remove quantitative easing by mid-year and begin slowly raising rates.

This punchbowl of free money sloshing around and the past decade or ZIRP (zero interest rate policy) has been feeding the bull and allowing valuations to get historically high. When the Fed Kool-Aid is gone the party is likely to quiet down. We are not expecting anything sinister or a deep nasty bear market, but a reversion to the mean and a decent correction cannot be ruled out. Market internals and technicals are also concerning as NASDAQ and Russell 2000 have failed to break out to new highs since the beginning of November.

There are also some geopolitical concerns as Russia masses troops on the Ukrainian border, basically challenging NATO and the U.S. Meanwhile China continues to stiff-arm the U.S. on many fronts. Putin and Xi Jinping exuded solidarity in their video summit. Iran and North Korea continue building their nuclear capacity and foment hostility.

But imminent pressure on the market is most likely to come from Washington as is often the case in the battleground that is the midterm election year. President Biden's approval rating has plummeted since the botched withdrawal from Afghanistan and many are not pleased with how he is handling international affairs and are opposed to Covid mandates. All this has hardened Republican opposition and is likely to boost their resolve and support in the midterm

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2022 Forecast: Early Year High, Worst Six Months Correction & Q4 Rally

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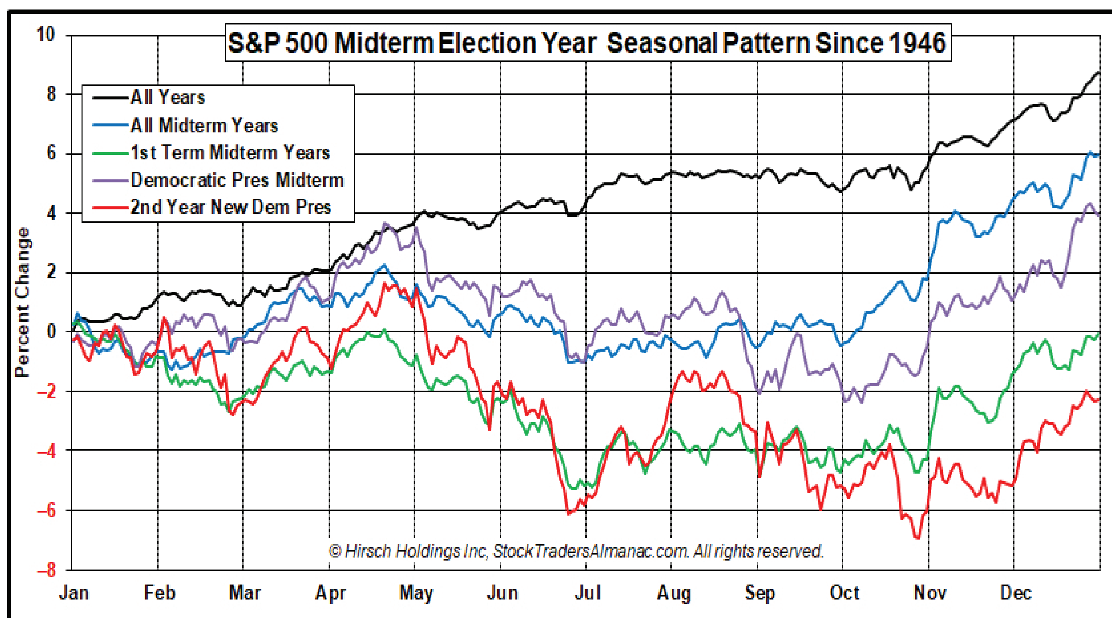
elections. And that is what makes midterm years a bottom picker's paradise.

Midterm election years are usually a volatile year for stocks as Republicans and Democrats vie for control for Congress, especially under new presidents. Incumbent presidents usually lose seats in the House of Representatives (see *2022 STA* page 28) and with the razor thin margins Dems have in both the House and Senate they could easily give up control of Congress in the midterms.

The chart here of the "S&P 500 Midterm Election Year Seasonal Pattern Since 1946" does not paint a rosy picture for 2022. Along with the pattern for all years and all midterm years since WWII we have overlaid the patterns for 1st term midterm years, Democratic president midterm years as well as the 2nd year of new Democratic presidents.

All midterm years average an S&P 500 gain of about 6%, Democratic president midterm years average about 4%, but 1st term midterm years average a loss of -0.6% and the 2nd year of new democratic presidents have been down -2.3% on average. All four tend to hit an early year high in April at the end of the Best Six Months with a low point during the Worst Six Months May-October.



Four Horseman of the Economy

Up until recently our lead horsemen DJIA along with S&P 500 and NASDAQ have been steadily making new highs, but we are seeing a few chinks in the armor as DJIA may be beginning to flatten out. The major averages are likely to notch more new highs before they submit to the usual midterm year correction as market internals indicate some broader market weakness.

Consumer spending and retail sales have been hot for the past year, but have pulled back recently as inflation continues to rise. Consumer confidence is concerning as it failed to break above 100 and has been falling steadily since April. If Covid shifts to a more endemic phase like the flu managed with vaccines and therapies as many experts have been indicating and the economy and life continues to return to normal — and inflation cools down by mid-2022 as we expect — then confidence will return to the consumer.

On the good news front the Unemployment Rate continues to decline and remains at a healthy low level of 4.2% seasonally adjusted (3.9% not seasonally adjusted). The "Help Wanted" signs are everywhere and most anyone who wants a job

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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. The Wilshire 5000 is a market-capitalization-weighted index of the market value of all US-stocks actively traded in the United States. As of December 31, 2020, the index contained only 3463 components. The index is intended to measure the performance of most publicly traded companies headquartered in the United States, with readily available price data. Past performance does not guarantee future results.

Moving Average Convergence Divergence (MACD): A trend-following momentum indicator that shows the relationship between two moving averages of prices.

Santa Claus Rally: Discovered and named by Yale Hirsch in 1972 and published in the *1973 Stock Trader's Almanac*. Santa Claus tends to come to Wall Street nearly every year, bringing a short, sweet, respectable rally within the last five days of the year and the first two in January. This rally has been averaged 1.3% S&P 500 gain since 1969. Santa's failure to show tends to precede bear markets, or times stocks could be purchased later in the year at much lower prices.

Triple Witch Week: Is the week containing the third Friday in March, June, September and December when stock options, index options and index futures expire on Friday.

January Effect: Is the tendency of small-cap stocks to outperform large-cap stocks in January.

January Barometer: Devised by Yale Hirsch in 1972, and published in the *1973 Stock Trader's Almanac*, the January Barometer states that as the S&P 500 goes in January, so goes the year. This indicator has registered eleven major errors since 1950 for an 84.5% accuracy ratio.

2022 Forecast: Early Year High, Worst Six Months Correction & Q4 Rally

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can find one. Wages also continue to rise so when the holdouts from the pandemic come back to work they should be well paid. Initial jobless claims up-ticked recently off the post-pandemic low, but this does not concern us as the level remains low and the trend is lower.

Finally, our inflation horseman as measured by our 6-month exponential moving average calculations on the CPI and PPI have risen sharply since summer 2020, which should not come as a major shock considering the massive government spending and quantitative easing we've had over the past 18 months or so. CPI is at the highest levels since 1991 and PPI, fueled higher by supply chain disruptions, is at levels not seen since the peak of the stagflation days in early 1975. As Covid turns endemic and manageable and supply chains bottlenecks are loosened, the Fed should be able to quell inflation sometime in the middle of next year.

Market at a Glance

Seasonal: *Bullish.* January is the fifth best month for DJIA and S&P 500 since 1950. #1 NASDAQ month since 1971. However, since 2000, January has been notably weaker and in Midterm years average performance for DJIA and S&P 500 turns negative. Santa Claus Rally ends on January 4, First Five Days concludes on January 7 and lastly the January Barometer at month's end. All three combined form our January Trifecta Indicator.

Fundamental: *Mixed.* Q4 GDP is now estimated to be 7.2% by the Atlanta Fed's *GDPNow* model, down from earlier estimates. Inflation metrics are elevated and running at multi-decade highs. Omicron variant is spreading rapidly and could lead to further supply chain disruptions. However, employment metrics remain positive and trending in the favorable direction while corporate earnings have been solid and are projected to remain so.

Technical: *Rebounding.* Late November/early December weakness hit DJIA hardest as it dipped below its 200-day moving average. S&P 500 and NASDAQ only briefly violated their respective 50-day moving averages. DJIA, S&P 500 and NASDAQ appear to be at various stages of forming "W" bottom patterns as long as the closing lows of December 1 are not breached. If all three are successful, then new highs are likely again in the near-term. Failure by one or more could lead to further weakness.

Monetary: *0 – 0.25%.* In response to well-above target inflation, the Fed is accelerating the pace of tapering bond purchases and has also pulled forward its expectations for actual rate hikes. Should current trends remain relatively intact for the next year, the Fed could increase its lending rate to 0.75 to 1% in small increments. Clearly higher than present, but from a historical perspective still low and substantially supportive.

Psychological: *Neutral.* According to Investor's Intelligence Advisors Sentiment survey Bullish advisors were at 42.2%. Correction advisors stand at 33.7% while Bearish advisors are at 24.1% as of their December 21 release. Thus far the typical year-end rally and its associated bullish sentiment is being challenged by the Fed and omicron. Where the market goes next is likely to be the direction sentiment takes. Current sentiment suggests a cautiously bullish stance.

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