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If Santa Claus Should Fail to Call

Michael McKerr
Senior Strategist, Institutional Trading Education

TD Ameritrade Institutional

"If Santa Claus should fail to call, bears may come to Broad and Wall." Turn on any financial media outlet around the holidays, and you will likely hear some strategist utter this phrase. The belief is that if the equity markets do not experience a Santa Claus rally (one trading day prior to Christmas holiday through the first two days of the new year), it means they were on the naughty list, and further losses may be in store throughout the coming January. Wall Street strategists love catchy one-liners that make headlines, but my goal is to debunk this myth and highlight a potential near-term opportunity.

First and foremost, there is no statistical evidence that supports the notion that if equity markets fall during that Santa Claus time period, they are likely to continue falling in the coming weeks or month. With statistical analysis, it is important to always consider the sample size of the study, and over the prior thirty years, the market's seasonal price action supports the opposite. Since 1989, the S&P500 has failed to score a Santa Claus rally 10 times, amounting to around a 1.85% drop on average. In the 10 and 22 trading days following the failed Santa Claus rally, the S&P500 continued lower only three times! Of those three times, over the next 10 and 22 trading days, it fell by an average of 5.3% and 6.2%, respectively (see chart below).

Year	Santa Claus Window Performance	Indexed Return
2018	1.29%	124.40
2017	1.11%	122.81
2016	0.31%	121.46
2015	-2.15%	121.09
2014	-2.94%	123.75
2013	-0.11%	127.50
2012	2.29%	127.64
2011	0.95%	124.78
2010	1.07%	123.61
2009	0.89%	122.30
2008	6.83%	121.22
2007	-3.29%	113.47
2006	0.38%	117.33
2005	-1.82%	116.89
2004	2.58%	119.06
2003	1.81%	116.07
2002	1.80%	114.02
2001	3.19%	112.00
2000	-4.04%	108.54
1999	1.51%	113.11
1998	4.76%	111.43
1997	-0.40%	106.37
1996	1.53%	106.79
1995	0.19%	105.18
1994	-0.10%	104.98
1993	-1.23%	105.09
1992	5.01%	106.41
1991	-2.42%	101.33
1990	3.26%	103.84
1989	0.56%	100.56
Beginning Index Value		100

Since 1989	
Rallies	20
Breaks	10
Average Rally	2.07%
Average Break	-1.85%

Data Source: Yahoo Finance

However, of the 10 failed Santa Claus rallies, seven of them resulted in S&P500 rallies averaging 1.7% and 3.6% over the next 10 and 22 trading days, respectively (see table above). There has been more than twice the number of rallies versus drops after failed Santa Claus rallies. Furthermore, using the first year as an indexed value, the total return is around 5% if one bought the S&P500 on the last day of a failed Santa Claus rally and sold 22 trading days (around a month) later. It is worth noting that the index's

return diminished in recent years due to systemic shocks like the Great Financial Crisis and the energy swoon of 2015-2016.

What appears to be the bigger takeaway from this myth busting exercise is that there is statistical evidence supporting a near-term trading opportunity during the Santa Claus rally window. Over the last 30 years, the number of rallies during the Santa Claus window exceeded the drops by exactly two to one. The average rally has been 2.07% and the average drop 1.85%. Using the first year as an indexed level, the total return has been more than 24% (see table to right) if having bought the S&P500 on the trading day prior to Christmas and subsequently selling it on the close of the second trading day of the new year.

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All too often we fall victim to simply believing trading adages' purported success. Think "Sell in May and Go Away" (click here), the "Death Cross" (click here) or in this case "If Santa Claus should fail to call, bears may come to Broad and Wall". Statistical analysis can help provide deeper insight into potential trading or investing opportunities while eliminating much of the disinformation that can surround specific adages or events. Like technical analysis, statistical analysis should be used as a complement to your existing trading or investment making decision process. That said, history argues that if Santa Claus doesn't put the markets on his nice list this year, it does not guarantee a weaker set of returns in the month ahead. Additionally, the case can be made that there is a potentially asymmetric risk-reward profile in using the Santa Claus window to buy the S&P500 on close of the trading day prior to Christmas then selling it on the close of the second trading day in January of the new year.

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