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December Almanac: Top Month Fueled by Holiday Cheer

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December is the number one S&P 500 month and the second-best month on the Dow Jones Industrials since 1950, averaging gains of 1.6% and 1.7% respectively. It's also the second best for NASDAQ (1971). Rarely does the market fall precipitously in December. When it does it is usually a turning point in the market — near a top or bottom. If the market has experienced fantastic gains leading up to December, stocks can pullback.

Trading in December is holiday inspired and fueled by a buying bias throughout the month. However, the first part of the month tends to be weaker as tax-loss selling and yearend portfolio restructuring begins. Regardless, December is laden with market seasonality and important events.

Small caps tend to start to outperform larger caps near the middle of the month (early January Effect). The "Santa Claus Rally" begins on the open on Christmas Eve day and lasts until the second trading day of 2019. Average S&P 500 gains over this seven trading-day range since 1969 are a respectable 1.3%.

This is the first indicator for the market in the New Year. Years when the Santa Claus Rally (SCR) has failed to materialize are often flat or down. The last six times SCR (the last five trading days of the year and the first two trading days of the New Year) has not occurred were followed by three flat years (1994, 2005 and 2015) and two nasty bear markets (2000 and 2008) and a mild bear that ended in February 2016. As Yale Hirsch's now famous line states, "If Santa Claus should fail to call, bears may come to Broad and Wall."

In the last seventeen midterm years, December's rankings slip modestly to #3 S&P 500 (1.8%) and DJIA (1.5%) and #5 NASDAQ (0.6% since 1974).

December Vital Stats (1950-2017)						
	DJIA		S&P 500		NASDAQ	
Rank[2]	2		1		2	
# Up	48		51		28	
# Down	20		17		19	
Average %	1.7		1.6		1.8	
4-Year Presidential Election Cycle Performance by %						
Post-Election	1.0		0.6		0.9	
Mid-Term	1.5		1.8		0.6	
Pre-Election	2.7		2.9		4.3	
Election	1.4		1.2		1.4	
Best & Worst November by %						
Best	1991	9.5	1991	11.2	1999	22.0
Worst	2002	−6.2	2002	−6.0	2002	−9.7
November Weeks by %						
Best	12/2/11	7.0	12/2/11	7.4	12/8/00	10.3
Worst	12/4/87	−7.5	12/6/74	−7.1	12/15/00	−9.1
November Days by %						
Best	12/16/08	4.2	12/16/08	5.1	12/5/00	10.5
Worst	12/1/08	−7.7	12/1/08	−8.9	12/1/08	−9.0
December 2018 Bullish Days: Data 1997-2017						
	5, 17, 21, 26		5, 11, 17, 18 21, 26		5, 6, 11, 21, 26	
December 2018 Bearish Days: Data 1997-2017						
	19, 31		31		19, 31	

[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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December Almanac: Top Month Fueled by Holiday Cheer

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Trading the day before and the day after Christmas is generally bullish across the board with the greatest gains coming from the day before (DJIA up eight of the last eleven). On the last trading day of the year, NASDAQ has been down in fifteen of the last eighteen years after having been up twenty-nine years in a row from 1971 to 1999. DJIA and S&P 500 have also been struggling recently and exhibit a bearish bias over the last twenty-one years.

Midterm Year December since 1950

	Rank[1]	Avg %	Up	Down
DJIA	3	1.5	12	5
S&P 500	3	1.8	12	5
NASDAQ*	5	0.6	6	5

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

** Since 1974*

December Outlook: Season of the Rally

It *is* the season for rallies, but not the Santa Claus Rally quite yet. As I reiterated once again recently on my blog, the Santa Claus Rally is not *any* seasonal rally in the fourth quarter of the year or around yearend, it is the usual short, sweet, respectable rally Santa brings to Wall Street within the last five trading days of the year and the first two in January.

The Santa Claus Rally was discovered and named by Yale Hirsch in 1972 and published in our *1973 Stock Trader's Almanac*. The Santa Claus Rally is not really a trading strategy it is an indicator, the first of our January Indicator Trifecta (more on that next month). Santa's failure to show tends to precede bear markets, or times stocks could be purchased later in the year at much lower prices. To Wit, *"If Santa Claus Should Fail To Call, Bears May Come To Broad and Wall."*

Santa Claus may not be coming to town until the end of December, but there is still plenty of market upside to be had seasonally and historically at present. Our good friend and options guru Larry McMillan enjoys a seasonal trade as well and has combined post-Thanksgiving bullishness, the "January Effect" of small cap stocks outperforming big cap stocks that now takes place in mid-December (pages 108 & 110 of the 2018 or 2019 *Stock Trader's Almanac*) with our Santa Claus Rally and goes long the Russell 2000 index of small cap stocks from the day before Thanksgiving through the second trading day of the New Year.

So I ran the numbers on that timeframe for the Dow, S&P 500, NASDAQ Composite and Russell 2000. As you can see in the table below small caps clearly outperform large caps over this period with an 82.1% win ratio and average gains of 3.4% since inception in 1979. The big caps and NASDAQ don't do too shabby either. The Dow and S&P log near an 80% win ratio with average gains around 2.5% since 1950 and NASDAQ has a 74.5% winning percentage with average gains of 2.85% since 1971 though median gains are 2.15%, reflecting some outsized gains over the years.

`Tis the Season for the Thanksgiving-Santa Claus Rally

Market Performance Day Before Thanksgiving-New Year Day 2

	S&P 500	DJIA	NASDAQ	Russell 2000
Up:	55	54	35	32
Down:	14	15	12	7
% Up:	79.7	78.3	74.5	82.1
Average:	2.48%	2.65%	2.85%	3.43%
Median:	2.33%	2.46%	2.15%	3.42%

S&P 500 & DJIA since 1949, NASDAQ since 1971 & Russell 2000 since 1979

The rest of December's market stocking is also stuffed rather full, but the first half of the month is usually weaker than the second half as tax loss selling dominates trading. As mentioned above small caps tend to begin to outpace large caps around mid-December and then we serve up Wall Street's only "Free Lunch" just before Christmas (Almanac page 112).

From the list of stocks making new 52-week lows on December 21, 2018 we compile our menu of "Free Lunch" stocks poised for a bounce-back rally. Since 1975 this list of stocks has beaten the NYSE Composite by 8.9% on average with an average gain of 11.9% vs. 3.0% for the index.

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December Outlook: Season of the Rally

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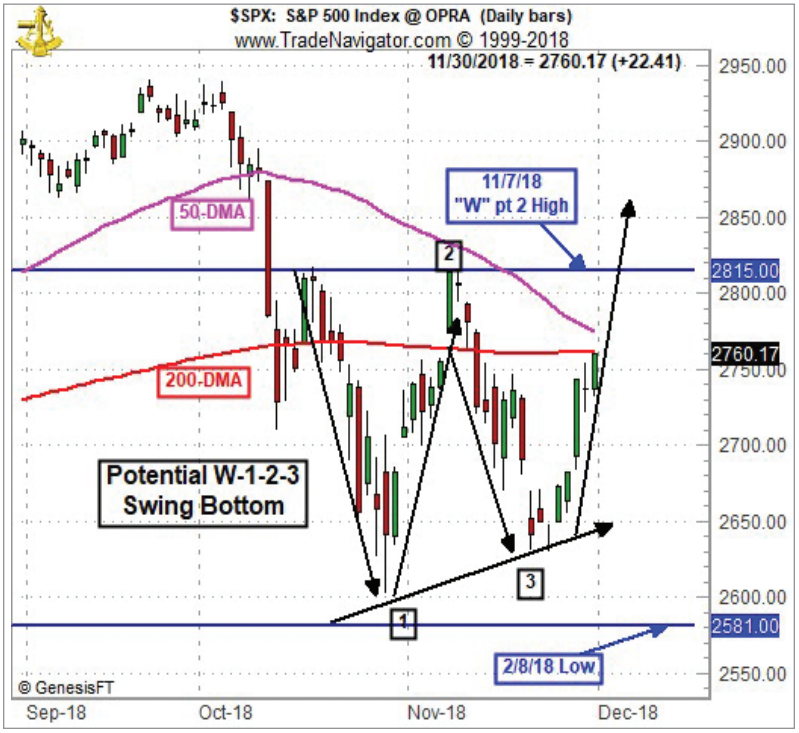
Since our most recent bout of "Octoberphobia" that reaffirmed "Sell in May" is not dead, the market has been attempting to rally, albeit in fits and starts. We have been saying for months, especially in our "*Market at a Glance*," that the Fed is the biggest risk to the market and the economy and now Chairman Powell's kind words the last week of November sent the market soaring back.

But there is still work to do and risks abound. Yes, we are still bullish on the "Sweet Spot" of the 4-Year Cycle from Q4 in the midterm year through Q2 of the pre-election year (Q4 2018-Q2 2019), but we are concerned after that and will layout our full Annual Forecast for 2019 in the later part of December.

Finally, technically speaking we are tracing out a potential "W-1-2-3 Swing Bottom" pattern as shown in the graph below. If we can clear the midpoint of the "W" at point 2 in the chart, at the early November highs, that would be constructive for the market to move to new highs. Once we clear that level, it becomes support and if breached again to the downside it would be concerning. The rising trend from point 1 to point 3 in the graph is also encouraging.



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.

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Market at a Glance

Seasonal: *Bullish.* December is the number one S&P 500 (+1.6%) month and second best for DJIA (+1.7%) and NASDAQ (1.8% since 1971). Rarely does the market fall precipitously in December. The "January Effect" of small-cap outperformance starts in mid-December. Santa's Rally begins on Monday December 24 and lasts until the second trading day of the New Year. S&P has averaged gains of 1.3% since 1969. In years when Santa Claus did not come to Wall Street, bear markets or sizable corrections have often materialized in the coming year.

Psychological: Flat. According to *Investor's Intelligence* Advisors Sentiment survey bulls are at 38.3%. Correction advisors are at 41.1% and Bearish advisors are 20.6%. The slow unwinding of bullish sentiment, to the lowest level of bulls since early 2016, is a positive. This would suggest there is additional capital available on the sidelines waiting to be put to work (or short positions that will need covering) when the market begins to rally.

Fundamental: *Firm-ish.* U.S. labor market remains quite firm with unemployment at just 3.7% and 250,000 net new jobs added in October. U.S. GDP is also ok with the Atlanta Fed's *GDPNow* model forecasting 2.6% growth for Q4, but is slower than previous quarters. Housing and auto markets are also somewhat tepid. Crude oil's decline is also noteworthy. Is crude merely reacting to excess supply and sluggish demand or is it possibly indicating slower global growth? Most likely crude's sell off is an indication of excess supply and waning summertime driving season demand.

Technical: *Challenged.* S&P 500 and NASDAQ are below their respective 50- and 200-day moving averages. DJIA reclaimed its 200-day moving average November 28. NASDAQ's chart is the weakest with a "death cross" registering on November 27. One positive thus far is the lows from earlier in the year have held. A break out above early November highs, by all three indices that holds, would be bullish.

Monetary: *2.00-2.25%.* The Fed remains the single biggest risk to the market and the economy. Rates do need to return to a neutral range, but exactly what neutral is remains unclear. Last month's rather hawkish tone on interest rates has softened significantly this week as Fed Chairman Powell announced that the Fed's benchmark rate was *"just below the broad range of estimates of the level that would be neutral for the economy."* After nearly a decade at zero, a brief pause to evaluate the impact of recent hikes does not seem unreasonable.

"The Fed remains the single biggest risk to the market and the economy. Rates do need to return to a neutral range, but exactly what neutral is remains unclear. Last month's rather hawkish tone on interest rates has softened significantly this week as Fed Chairman Powell announced that the Fed's benchmark rate was "just below the broad range of estimates of the level that would be neutral for the economy."

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