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December Almanac: Small Cap Effect & Santa Claus Rally

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YALE HIRSCH (1923-2021)

It is with great sadness that we inform you that Yale Hirsch, founder and creator of the *Stock Trader's Almanac* passed away earlier this month after an amazing 98-year run. He was a Wall Street legend and iconic thinker who put market seasonality, cycles, trends and patterns in every investor's and trader's arsenal. Yale discovered the "January Barometer," "Santa Claus Rally," the "Best Six Months Switching Strategy" (beyond "Sell in May"), as well as many of the other seasonal and cyclical patterns we all rely on. We proudly stand on his ample analytical shoulders. Rest in peace Pop!

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December is the number three S&P 500 and Dow Jones Industrials month since 1950, averaging gains of 1.5% on each index. It's the second-best Russell 2000 (1979) month and third best for NASDAQ (1971). In 2018, DJIA suffered its worst December performance since 1931 and its fourth worst December going all the way back to 1901. However, the market rarely falls precipitously in December and a repeat of 2018 is not all that likely. When December is down 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 in the first half of the month.

In the last seventeen post-election years, December's ranking slipped to #7 S&P 500, #7 NASDAQ and DJIA #5. Small caps, measured by the Russell 2000, tend to have a field day in post-election-year Decembers. Since 1981, the Russell 2000 has lost ground three times in ten post-election years in December. The average small cap gain in all ten years is a solid 2.2%.

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Post-Election Year December since 1950

	Rank[1]	Avg %	Up	Down
DJIA	5	1.0	12	5
S&P 500	7	0.6	13	4
NASDAQ*	7	0.9	7	5

[1] *Based upon the average historical monthly performance of the indices in comparison to other months of the year.*
* Since 1971

December Vital Stats (1950-2020)

	DJIA		S&P 500		NASDAQ	
Rank[2]	3		3		3	
# Up	50		53		30	
# Down	21		18		20	
Average %	1.5		1.5		1.7	
4-Year Presidential Election Cycle Performance by %						
Post-Election	1.0		0.6		0.9	
Mid-Term	0.9		1.2		–0.3	
Pre-Election	2.7		2.9		4.2	
Election	1.5		1.3		1.7	
Best & Worst December by %						
Best	1991	9.5	1991	11.2	1999	22.0
Worst	2018	–8.7	2018	–9.2	2002	–9.7
December Weeks by %						
Best	12/2/2011	7	12/2/2011	7.4	12/8/2000	10.3
Worst	12/4/1987	-7.5	12/6/1974	-7.1	12/15/2000	-9.1
December Days by %						
Best	12/26/2018	5.0	12/16/2008	5.1	12/5/2000	10.5
Worst	12/1/2008	–7.7	12/1/2008	–8.9	12/1/2008	–9.0
December 2021 Bullish Days3: Data 2000-2020						
	3, 13, 15, 21-23, 28		15, 16, 22, 23, 28		3, 6, 8, 9, 15, 22 23, 27, 28	
December 2021 Bearish Days4: Data 2000-2020						
	2, 17		17, 31		17, 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.*

Inside
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December Almanac: Small Cap Effect & Santa Claus Rally

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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 year-end 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 December 27 and lasts until the second trading day of 2022. Average S&P 500 gains over this seven trading-day range since 1969 are a respectable 1.3%.

This is our 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, 2004 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."

December Outlook: New Highs Likely Before Year-end

Seasonal patterns continue to reassert themselves and that is positive for the probability of new highs by year-end. Typical September and early October weakness created a solid set up for our October 8 Seasonal MACD Buy Signal. Then late-October seasonal strength carried into early November before the usual pre-Thanksgiving weakness ensued. As we head into December, the market is trying to find its footing and we look for the market to shake off its current funk as it usually does and rally into the year-end holiday buying spirt.

As the S&P 500 is up rather impressively, 24.9% year-to-date this year through the close on the Tuesday before Thanksgiving, we ran the numbers on the 33 previous years with double digit year-to-date gains at this juncture since 1950. There are a few blemishes, but in general market gains continued into year-end.

Most importantly, there are no major selloffs on this list. The big December decline of -9.2% in 2018 came after the S&P 500 was down -1.2% at this point in the year. After double-digit YTD gains the S&P 500 was up 70% of the time from the Tuesday before Thanksgiving to year-end for an average gain of 2.3%.

Also of note is that the Santa Claus Rally suffered only four losses in these years. But these four down SCRs in 1955,

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December Triple Witching Week is more favorable to the S&P 500 with Monday up thirteen of the last twenty-one years while Triple-Witching Friday is up twenty-six of the last thirty-nine years with an average 0.24% gain. The entire week has logged gains twenty-eight times in the last thirty-seven years. The week after December Triple Witching is the best of all weeks after Triple Witching for DJIA and is the only one with a clearly bullish bias, advancing in twenty-nine of the last thirty-nine years. Small caps shine especially bright with a string of bullish days that runs from December 21 to 28.

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 nine of the last fourteen). On the last trading day of the year, NASDAQ has been down in fifteen of the last twenty-one 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. Russell 2000's record very closely resembles NASDAQ, gains every year from 1979 to 1999 and only six advances since.

S&P 500 Double Digit YTD Gains Tuesday B4 Thanksgiving Since 1950

Year	YTD Gain Tue B4 THX	November Change	December Change	Tue B4-YE Change	Santa Claus Rally	Year Change
1954	37.2 %	8.1 %	5.1 %	5.7 %	3.0 %	45.0 %
1975	32.3	2.5	– 1.2	– 0.6	4.3	31.5
1995	30.7	4.1	1.7	2.6	1.8	34.1
1980	29.1	10.2	– 3.4	– 2.6	2.0	25.8
1997	28.4	4.5	1.6	2.1	4.0	31.0
1958	27.6	2.2	5.2	8.2	3.6	38.1
1955	26.9	7.5	– 0.1	– 0.4	– 0.9	26.4
2013	26.4	2.8	2.4	2.5	0.2	29.6
2019	25.3	3.4	2.9	2.9	0.3	28.9
2021	*24.9*	*1.9 **	—	—	—	—
1961	23.5	3.9	0.3	– 0.3	0.4	23.1
1996	22.7	7.3	– 2.2	– 2.0	0.1	20.3
2009	22.4	5.7	1.8	0.9	1.4	23.5
1989	22.3	1.7	2.1	4.1	4.1	27.3
1998	21.9	5.9	5.6	3.9	1.3	26.7
1985	20.0	6.5	4.5	5.3	1.1	26.3
2003	19.8	0.7	5.1	5.5	2.4	26.4
1983	18.6	1.7	– 0.9	– 1.1	2.1	17.3
1950	18.6	– 0.1	4.6	2.7	3.1	21.8
1986	17.5	2.1	– 2.8	– 2.4	2.4	14.6
2017	16.1	2.8	1.0	2.9	1.1	19.4
1967	15.9	0.1	2.6	3.6	0.3	20.1
1963	14.7	– 1.1	2.4	3.6	2.3	18.9
1991	14.5	– 4.4	11.2	10.4	5.7	26.3
1964	14.3	– 0.5	0.4	– 1.1	0.6	13.0
1999	14.3	1.9	5.8	4.6	– 4.0	19.5
1972	13.8	4.6	1.2	1.6	3.1	15.6
1976	13.1	– 0.8	5.2	5.4	0.8	19.1
2020	12.5	10.8	3.7	3.3	1.0	16.3
2006	12.4	1.6	1.3	1.1	0.0	13.6
2014	11.8	2.5	– 0.4	– 0.4	– 3.0	11.4
1968	11.2	4.8	– 4.2	– 3.2	– 1.2	7.7
1951	11.1	– 0.3	3.9	4.8	1.4	16.5
2012	10.4	0.3	0.7	2.8	2.0	13.4
Average:		**3.1 %**	**2.0 %**	**2.3 %**	**1.4 %**	**22.7 %**
Median:		**2.5 %**	**1.8 %**	**2.7 %**	**1.4 %**	**21.8 %**
Up:		**28**	**25**	**23**	**29**	**33**
Down:		**6**	**8**	**10**	**4**	**0**

** As of the close of 11/23/2021.*

December Outlook: New Highs Likely Before Year-end

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1968, 1999 and 2014 were followed by flat years in 1956 and 2015 and down years in 1969 and 2000. As Yale's famous line states (*2021 Almanac* page 116 and *2022 Almanac* page 118): "If Santa Claus Should Fail To Call, Bears May Come to Broad and Wall."

December typically starts out weak as tax-loss selling ramps up and with the big gains this year we believe that early December weakness is likely to materialize. Then as you can see in the typical December chart here stocks usually begin to takeoff around mid-month led by small caps and the Russell 2000.

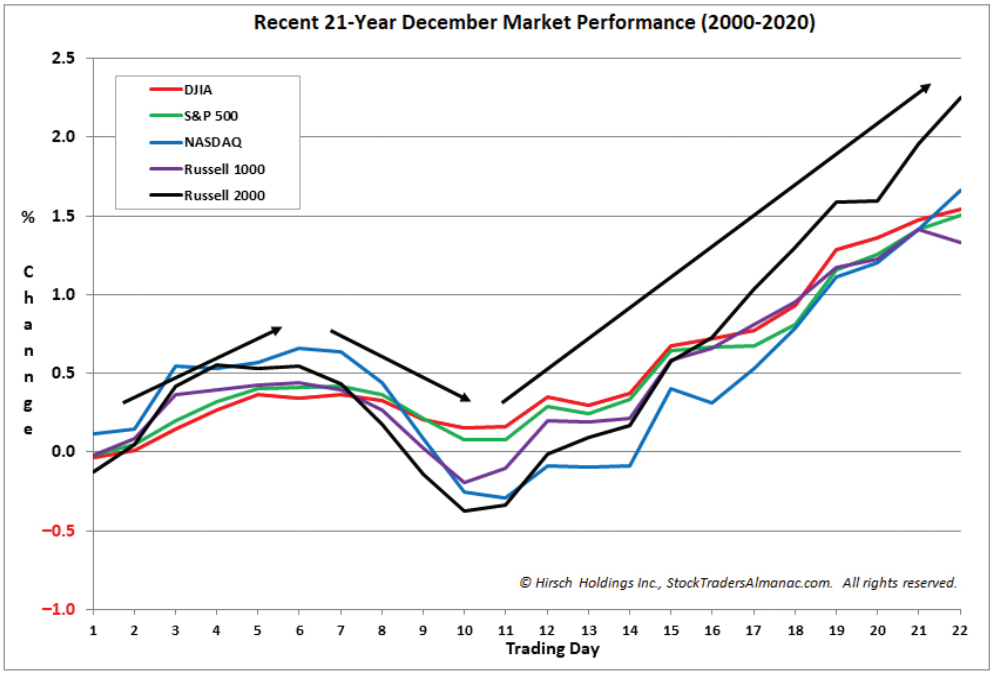
This is what used to be known as the "January Effect:" small caps outperforming large caps in the month of January. Nowadays most of the so-called January Effect tends to take place in the last half of December (*2021 Almanac* pages 110 & 112, 2022 pages 112 & 114). The January Effect is not to be confused with the January Barometer (*2021 Almanac* page 16, 2022 page 18), which states as the S&P 500 goes in January, so goes the 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. This short, sweet rally is usually good for about 1.3% on the S&P 500, but as we alluded to before the real significance of the SCR is as an indicator.

It is our first seasonal indicator of the year ahead. Years when there was no Santa Claus Rally tended to precede bear markets or times when stocks hit significantly lower prices later in the year. We get an even better indication of the New Year when we combine SCR with the First Five Days Early Warning System (*2021 Almanac* page 14, *2022 Almanac* page 16) and the full-month January Barometer reading. We call this the "January Indicator Trifecta."

When all three are up the S&P 500 has been up 90% of the time, 28 of 31 years, with an average gain of 17.5%. When any of them are down the year's results are reduced and when all three are down the S&P was down 3 of 8 years with an average loss of -3.6% with bear markets in 1969 (-11.4%), 2000 (-10.1%) and 2008 (-38.5%), flat years in 1956 (2.6%), 1978 (1.1%) and 2005 (3.0%). Down Trifecta's were followed by gains in 1982 (14.8%) and 2016 (9.5%).

Our outlook remains bullish for the remainder of 2021 and as long as Covid cases don't explode again and many places go on lockdown or ramp up restrictions majorly, new highs are likely before year-end and we would not be surprised to see the S&P 500 encroach upon the big round number of 5000. 2022 will likely be a different case and we will address that thoroughly in our 2022 Annual Forecast next month.



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.

Market at a Glance

Seasonal: *Bullish.* December is the #3 month for DJIA, S&P 500 and NASDAQ. It is also the second month of the "Best Months" and best three consecutive month span. Performance is modestly softer in post-election years. Santa Claus Rally begins on the open on December 27 and runs until the close on the second trading day in January.

Fundamental: *Mixed.* According to the Atlanta Fed's *GDPNow* model, Q4 growth is forecast at 8.6% as of its most recent update on November 24. However, inflation is running at multi-decade highs and covid-19 cases are trending higher which could pull activity lower. Q3 corporate earnings have largely been a homerun but comparisons will begin to get tougher. October's jobs report was solid, but a sizable chunk of the gains may have been temporary holiday-related positions that may not last.

Technical: *Consolidating.* After breaking out to new all-time highs in early November, DJIA and Russell 2000 have retreated. S&P 500 and NASDAQ have fared better with both reaching new highs the week before Thanksgiving prior to the early Thanksgiving week retreat. S&P 500 and NASDAQ remain above their respective 50-day moving averages, but DJIA and Russell 2000 fell through their 50 DMAs on the Black Friday selloff. For the rally to resume in earnest, DJIA and Russell 2000 need to find support. Key levels to watch appear to be DJIA 35600 and Russell 2000 at 2300. A meaningful breach of these levels could weigh heavily on S&P 500 and NASDAQ.

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Monetary: *0 – 0.25%.* At its regularly scheduled meeting at the start of November the Fed did as was widely anticipated, it announced that bond purchases would be tapered. They announced hard numbers for November and December but left subsequent monthly adjustments open and data dependent. Fed Chairman Powell will remain which; depending on how you view the Chairman may be a blessing or a curse. At a bare minimum his reappointment does rule out the uncertainty of someone new taking his place. Overall, even with the reduction in bond purchases, Fed policy remains highly supportive and we believe bullish for stocks at this time.

Psychological: *Near Frothy.* According to *Investor's Intelligence* Advisors Sentiment survey Bullish advisors jumped to 57.2%, Correction advisors retreated to 21.4% while Bearish advisors stood at 21.4% as of the November 17 release. The jump in bullish sentiment was supported by a breakout to new all-time highs and perhaps an early sampling of holiday spirit. With the rally stalling, sentiment eased slightly over the last week to 56.6% Bulls and 21.7% each for Correction and Bears. It is common for sentiment to remain elevated during the holiday season as it has typically been a bullish time for stocks.

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