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Market Commentary

Navigating Year-End Seasonality

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Navigating Year-End Seasonality

Stock market seasonality refers to the patterns in price movements that occur predictably at certain times of the year. Towards the end of the calendar year, well-known trends, such as tax-loss-selling and the Santa Claus rally, always draw public attention. These trends can act as headwinds or tailwinds, or just add noise to an already uncertain market. Looking at historical data can give us clues about why these patterns occur and what they might mean in the current environment.

The graphs below illustrate the average monthly returns of the S&P/TSX Composite (TSX) and S&P 500 (SPX) over the last 50 years. The blue market return bars, reveal that on average, September is the most negative month in both Canada and the U.S. This seasonality is influenced, in part, by tax loss selling. Although tax loss selling can extend until December 27, money managers, depending on the fiscal year-end of their funds, tend to do these transactions starting as early as September and are finished by mid-December. Next is the "October effect", which suggests that stocks tend to decline during this month, as with the famous 1929 and 1987 market crashes. The 50-year historical data however indicates that this phenomenon is more psychological than factual. Under normal conditions, seasonality tends to improve from this point onward, transitioning from a headwind to a tailwind. Then, as the year draws to completion, historical data suggests above-average returns for both November and December.

Historical Monthly Return Trends S&P/TSX Composite [Top]; S&P 500 [Bottom]

Source: Bloomberg; Raymond James Ltd.; Data as of October 31, 2023.

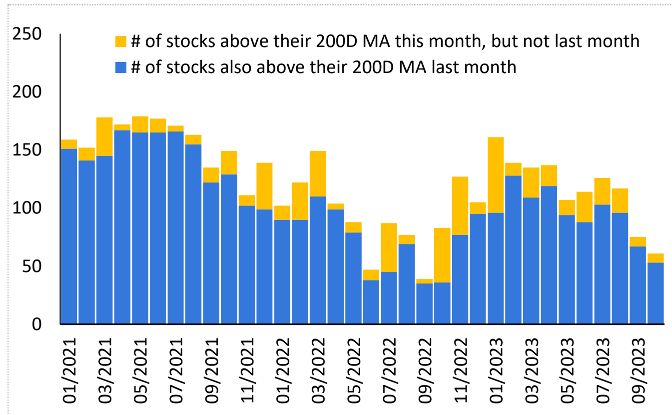
The year-end effect known as the "Santa Claus rally" typically occurs around Christmas and sometimes extends into the first few trading days of the new year. During this period, there is often a surge in stock prices and trading volumes. This surge has been attributed to numerous factors, including tax considerations, fund manager window dressing, positive investor sentiment, holiday optimism, and anticipation of the new year. This time of the year also coincides with when professional money managers are more likely to be on vacation and retail traders, generally being a more optimistic bunch, have more influence on prices.

Implications for Today's Market

The seasonality patterns mentioned above are based on average market conditions, over a long period of time. To provide more insightful analysis for the current environment, those graphs also display the average returns in each month for years that ended with top quartile returns and those that ended with bottom quartile returns. Additionally, we included the monthly returns of 2023 as red dots on the graphs. For both the TSX and SPX, in the first half of this year, the monthly returns were quite erratic, reflecting high market volatility. However, since July, the 2023 monthly returns have more closely aligned with the average trend of years ending in the bottom quartile. This alignment is evident in the three consecutive months of weakening returns and the magnitude of the recent dip. As of the year-to-date returns, both the TSX (+0.1%) and SPX (+10.7%) are still above the bottom quartile cut-offs, especially for the SPX.

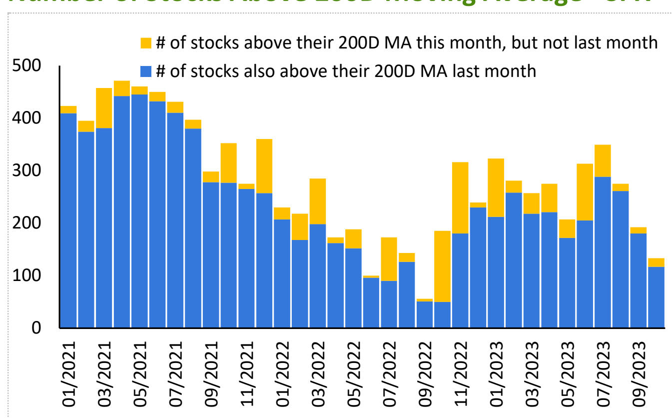
Two aspects of the market that we are watching to see how 2023 will end are corporate earnings and market breadth/strength. For the TSX, year-over-year next-twelve-month earnings per share (YoY NTM EPS) growth is still negative, which means that combining the EPS of all the companies in the index provides a lower forecast of profits than last year at this time. We anticipate ongoing pressure on earnings due to the global economic slowdown and remain cautious about negative surprises and guidance adjustments during the current earnings season. Additionally, market breadth is currently considered weak, as we have more stocks declining than advancing. The number of stocks trading above their 200-day moving average (200D MA), has significantly declined in September and remained weak in October. Concerns about earnings and the fading momentum may indicate lacklustre performance for the remainder of the year and less positive year-end effects. For the SPX, despite its YoY NTM EPS growth turning positive earlier this year, the recent increase seems counterintuitive given rising interest rates and slowing nominal GDP environment. We anticipate that earning expectations might decrease later this year and into 2024, if our expectations of a recession in the U.S. come to pass. The concentrated leadership of the "Magnificent 7" has been widely discussed this year. Similar to the TSX, the market breadth of the SPX is also weak; the number of stocks trading above their 200D MA has significantly declined since August and is still bottoming in October. Despite the SPX generating approximately 11 per cent year-to-date, 10-year U.S. Treasuries touching 5 per cent and growing concerns over a slowing economy might mute potential year-end benefits.

Number of Stocks Above 200D Moving Average - TSX



Source: Bloomberg; Data as of October 30, 2023.

Number of Stocks Above 200D Moving Average - SPX



Source: Bloomberg; Data as of October 30, 2023.

In conclusion, although historical return patterns can offer some insights, the current heightened economic and market uncertainties stemming from macro factors like inflation and rate hikes make it extremely challenging to predict short-term market movements. Attempting to time the market has rarely been a reliable strategy. Therefore, as we approach year-end, the most prudent approach for long-term investors is to ensure that their investment strategy is suited to their objectives and risk tolerance, while tactically taking advantage of tax-planning techniques and opportunities to rebalance their portfolios in consultation with their trusted advisor.

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