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Spooky Halloween effect as witches bring in riches 30 October 2011

Well, we've had Halloween. It's time to buy shares. That's according to Dr William Ziemba, a Professor in financial modelling at Sauder School of Business in Canada.

The Halloween Effect is one of a number of seasonal anomalies that can apparently explain market trends and guide us in our investment decisions.

Essentially the Halloween Effect consists of buying the market six trading days before Halloween and selling on 1st May the following year. If you had adopted this trading pattern from 1993 to 2010, buying stocks in the S&P500 Index, you would have done a whole lot better than just buying and holding.

A Halloween portfolio would have netted you a 373% return over this 17-year period, compared to a 96% return from a more passive approach. The results would have been even better if you had set your sights on smaller companies and bought stocks in the Russell 2000 Index. The Halloween portfolio would have grown by 494% compared to a 204% for a buy and hold portfolio.

Actually we've left it too late to apply this theory and in order for it to work, investors must be very disciplined. Any deviations – you wait too long to buy, or you hold on beyond May – and the results can differ significantly.

But it is interesting to examine the logic behind such trading patterns.

Over the years researchers have tried to understand these seasonal anomalies. One of the more compelling explanations is that behaviour is indeed seasonal.

It seems that when investors are optimistic, we are more willing to take risks. That sounds logical.

Because Halloween is at the beginning of the festive season featuring Thanksgiving and Christmas, American investors feel optimistic and that leads to better market returns in November and December than are normally experienced in September and October.

Interestingly, there is some evidence that the Halloween Effect works as well in the Southern Hemisphere as it does in the US, even though there should be seasonal variations.

Researchers have provided a different explanation for this. It seems that the months November through February are generally better for markets because investors around the world tend to be



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overly optimistic about the upcoming year. According to the research, investors are optimistic at the end of each year – “next year will be better” – and at the beginning of the year because they can start with a clean slate.

After the year that’s thankfully coming to an end, I can imagine investor optimism going into overdrive. It would be just too painful to believe that 2012 is going to see the volatility and negative returns that have been such a feature of 2011.

Perhaps that is why the US market rallied so hard in October. Investors didn’t wait for six days before Halloween, they started early and were clearly happy to take on risk. With no real news, it was clearly optimism that drove the rally.

As we put away our Halloween costumes, perhaps it’s time to retrieve our cash from its tomb and bring it back to life in the share market!