Does January predict the full year?

One of the well-known Wall Street tales is that whatever happens in January is likely to be a good indication of how the rest of the year will be. In the interest of getting a better understanding of the probabilities, I studied the returns of the Standard & Poor's 500 for the last 50 years. The results of that study give some assurance that January may point the direction for the months that follow, but the early going is by no means a guarantee of what's to come.

Let's start with the reality that over extended periods of time two out of three years will show positive returns. So when we look at the span from 1968 to 2017, we learn that (after excluding years that showed gains or losses less than 2%), exactly two out of three years registered significant gains. That was as expected.

More interesting is the fact that in the years when the January number was positive, three-quarters of the time the full-year result was also positive. In four of the years with an up result for January, the direction over the remainder of the year was down.

At this point, one is tempted to buy in to the reliability of the January indicator. I suggest that investors take that thought with a grain of salt. What muddies the waters were the findings of the last 10 years, a decade when January's net pointed the wrong direction four times, most recently in 2016 and 2014.

Beyond the note that may be struck in the opening stanza, there are several realities ahead. One is that it's quite likely that the new year will bring with it much more volatility than we've recently experienced. 2017 was a year of unusually steady and well above average gains. In almost every year, there has been an interim correction of 10% or so sometime along the way.

What's more, there will be increasing headwinds along the way as the Fed continues its program of raising short-term interest rates. At latest check, three more notches up appeared to be on the agenda for the quarters ahead.

Then there's the one-time benefit from reduced corporate tax rates. From a naïve vantage point, one can assume that an 8-10% gain in net income would be reflected in a similar advance in stock prices. To some extent the gain is illusory since there is no change in pretax profits. In reality, it's an accounting change that may have meaningful impact by enabling companies to use the additional cash flow to accelerate future growth. In and of itself, though, the advance is not one that should stimulate a proportionate increase in stock prices.

Indeed, in the aftermath of an unusually strong market advance, in which valuations have been stretched toward the upper end of the historical range, one would be better advised to dial down expectations. Viewed against the continuum of past years' results and valuations, a better bet (and hope) would see 2018 gains in the low single digits.