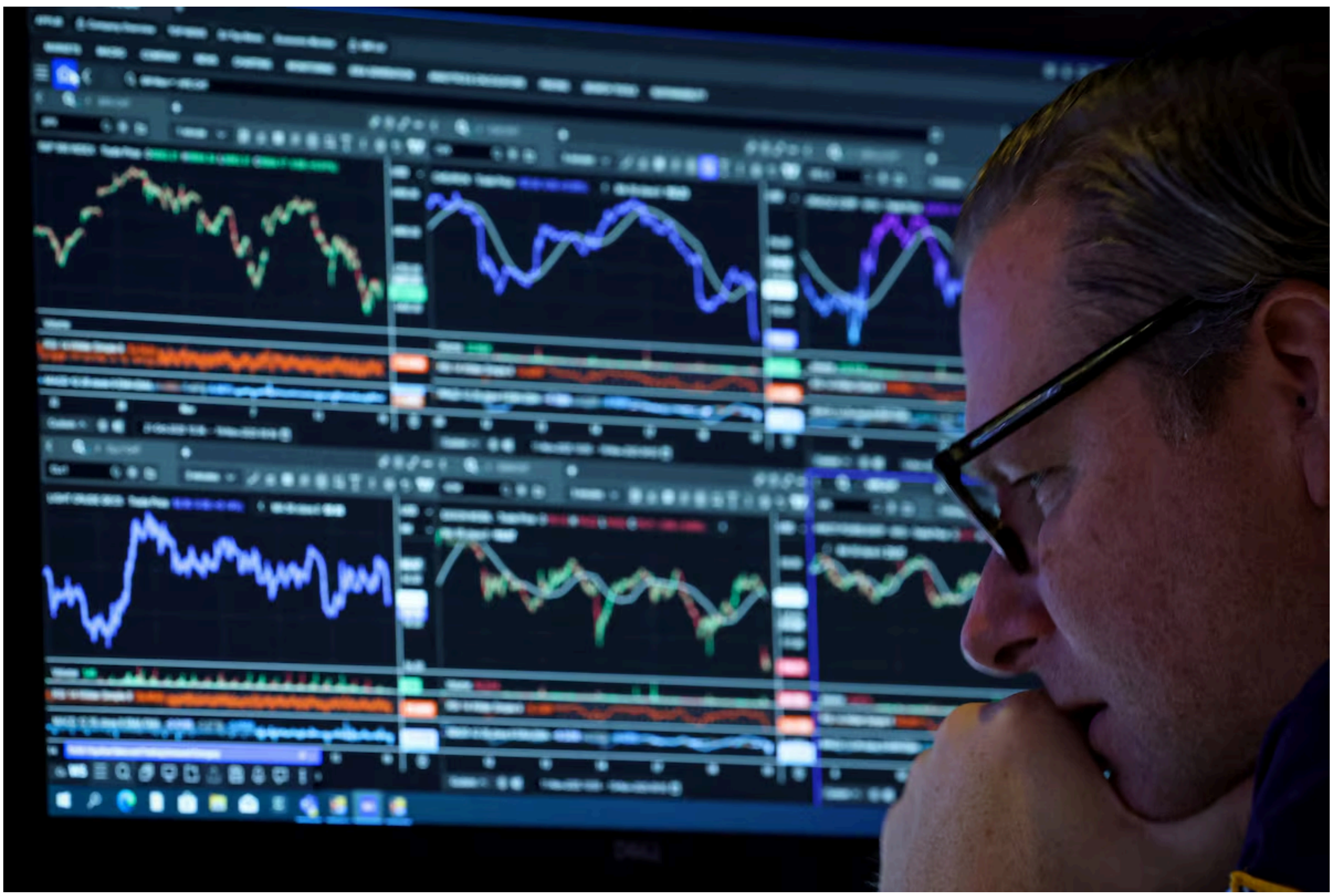
OPINION

Is the 'January Effect' a slam dunk this year?

GEORGE ATHANASSAKOS
SPECIAL TO THE GLOBE AND MAIL
PUBLISHED 2 HOURS AGO



A specialist trader works inside a booth on the floor at the New York Stock Exchange in November.

BRENDAN MCDERMID/REUTERS

Listen to this article

Learn more about audio

06:20 1X

With January around the corner, investors must be getting eager to trade. This is because January tends to be a strong month for stocks, particularly those of smaller companies. But is stock market strength in January, the so-called January Effect, a foregone conclusion? To answer this, we need to understand what drives such seasonal behaviour. In my opinion, the January Effect is driven by portfolio managers’ portfolio rebalancing and gamesmanship throughout the year.

According to the gamesmanship hypothesis, institutional investors are net buyers of risky securities in the early months of the year when they are less concerned about including well-known, low-risk or risk-free securities in their portfolios and are trying to outperform the market or benchmarks.

Toward the later months of the year, portfolio managers acquire these kinds of securities and divest from lesser-known, risky, or poorly performing stocks to lock in returns and/or window dress to spruce up their portfolios. The excess demand for risky securities early in the year bids the prices of these securities up and vice versa for lower-risk securities.

Contra Guys: December tax-loss selling may be your perfect buying opportunity

The opposite happens in the last few months of the year. This is borne out by the findings of research I carried out a few years ago using Canadian Financial Markets Research Center data. For the period 1957-2007, the average January return for the equally-weighted portfolio of stocks (emphasis on small cap) was 5.03 per cent. The corresponding return for the value-weighted portfolio of stocks (emphasis on large cap) was 2.20 per cent and that of government bonds was not statistically different from zero. Smaller-cap stocks show strength at the beginning of the year, with the rest of the year, especially the second half of the year, showing widespread weakness in relation to January. The opposite is true for larger-cap stocks and Government of Canada bonds.

However, I find that the strength in risky securities at the beginning of the year is not a sure thing, but largely depends on what institutional investors think of the year ahead. A January seasonal effect is mainly observed when there is no bear market expectation for the year ahead. In bear markets no – or at least a considerably weakened – January stock return seasonality is documented.

The opposite is true for Government of Canada bond returns. This is because portfolio managers should not invest in risky securities indiscriminately, irrespective of whether the year is (or is expected to be) a bull or bear market. Portfolio managers should invest in risky securities when the year ahead is expected to be a good one and withhold their investment from such securities if the year ahead is forecast to be adverse.

Andrew Willis: Canadian IPO market could warm up in 2026 as Bay Street eyes U.S. debuts

I also find that strong January returns beget positive returns in the rest of the year for the equally weighted index and, naturally, for the year as a whole. This supports the popular expression “As January goes, so goes the year.” In my aforementioned research, I looked at financial security returns in January vs. the rest of the year in years when the equally weighted index declined in January, as well as when this index rose in January for the same period.

The January return in a down market was -3.42 per cent. For the rest of the year, the mean monthly return was not statistically different from zero. As a result, when the market goes down in January, the rest of the year goes nowhere and if one includes the strong negative January returns in the calculation, the whole year is a down year.

For Government of Canada bonds, the mean January return is 0.22 per cent in a down market, while for the rest of the year, the mean monthly return is 1.32 per cent. What are the findings in an up market (i.e., when the equally weighted index went up) in January? The average January return for the equally weighted index is 7.67 per cent vs. an average monthly return of 1.39 per cent for the rest of the year.

Beaten-down TSX stocks that could now be end-of-year buys

As far as the Government of Canada bonds are concerned, the mean January return is 0.53 per cent vs. a mean monthly return of 0.50 per cent for the rest of the year. From the evidence on government bond returns in an up and down market, it is apparent that they tend to do much better when there are uncertainty and low returns in the stock market as opposed to when stock markets are doing well and there is confidence in their performance.

Consequently, the strength of risky securities at the beginning of the year is not a slam dunk. It all depends on institutional investors’ expectations of the year ahead. If institutional investors are, on average, right when they expect a bear market in the year ahead, and so they divest from risky securities at the beginning of the year, when portfolios are rebalanced, it is only natural to expect risky securities to experience weakness in January.

And the news on this front is not good, as the market has been driven to record height levels this year by retail investors, not institutional investors, who are sitting mostly on the sidelines according to Business Insider and Vanda Research, with the latter reporting that cumulative retail net purchases of stocks and ETFs hit the highest level in the first six months for 2025 in at least the past 10 years.

George Athanassakos is a professor of finance and holds the Ben Graham Chair in Value Investing at the Ivey Business School, Western University. His latest book is “Value Investing: From Theory to Practice”.

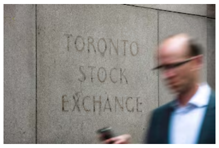
Report an editorial error

Report a technical issue

Editorial code of conduct

Related stories

How often should you update your portfolio? We put six under the microscope to find out



How often should investors rebalance dividend-focused portfolios?

Four strategies to remove risk from your portfolio