



# Market Mybusters: The Counter-Cyclical Nature of Gold Prices & January as a Predictor of Market Performance for the Year



UW-Eau Claire Economics Department and The Chippewa Valley Center for Economic Research and Development

Students: Zach Hines, Eric Nohelty, Matt Porwoll, Lauren Buxton Faculty Mentor: Dr. Eric Jamelske

## So Goes January, So Goes the Year?

### The Market Hypothesis

As the name implies, "So Goes January, So Goes the Year" is a market hypothesis that states that the stock return in the month of January can be used as a predictor for the stock performance of the entire year. In order to test this theory we will compare returns from January against full year returns from 1980 to 2010. We will also attempt to predict 2011 stock returns based on the stock market performance of January 2011.

Figure 1:

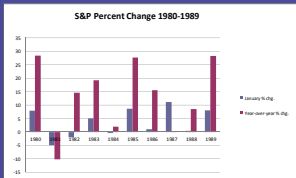


Figure 2:

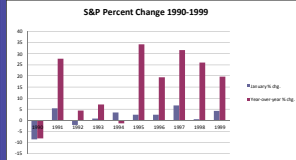


Figure 3:

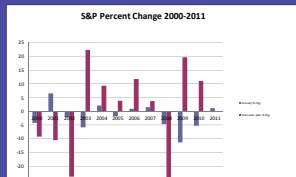


Figure 4:

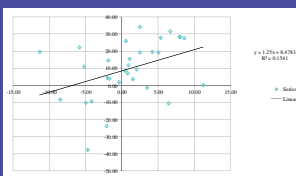


Figure 5:

Returns	JR (t)	YR (t)	JR (t-1)	YR (t-1)	JR (t-2)	YR (t-2)
Mean (t=Start)	6.17	16.14	4.07	16.74	4.56	-5.51
Standard Deviation (t)	3.74	17.68	3.38	15.55	2.35	6.51
Returns	JR (t)	YR (t)	JR (t-1)	YR (t-1)	JR (t-2)	YR (t-2)
Mean (t=Start)	-4.42	-0.93	-4.91	-17.79	-4.07	11.11
Standard Deviation (t)	3.15	17.29	2.33	12.76	1.78	6.20

**Conclusion-** Our data showed that annual returns followed January returns in 22 (71%) of the 31 years we tested. Although it seems that this relationship weakens when January returns are negative, our results confirm this market hypothesis and imply a relationship between January returns and annual returns.



## Abstract

There are many different theories and strategies concerning the stock market. We have compiled data to test two of these theories: The first theory we will be looking at is one that states that market performance in the month of January can be used as a predictor for the performance of the entire year. The second theory is that gold is counter-cyclical to the broad market and is a good place to invest in a bear market.

The Chippewa Valley Center for Economic Research and Development (CVCERD) collects market data on four different investment strategies and also provides an overview of overall market conditions through its Stock Market Project. In addition to testing these market hypotheses we also present an overview of the broad stock market and the Eau Claire Basket (an index of locally presented publically traded companies).

## ECB Track

Figure 6:

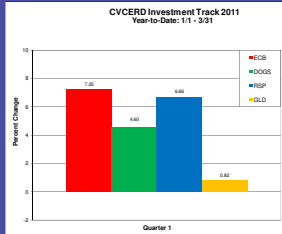


Figure 7:

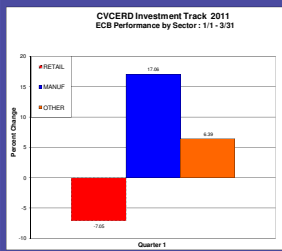


Figure 8:

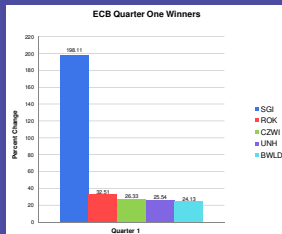


Figure 9:

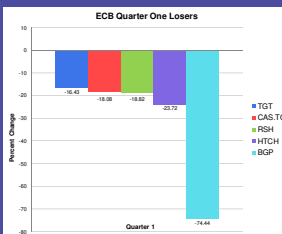


Figure 6 shows quarter one returns for the Eau Claire Basket (ECB), Dogs of the Dow (DOGS), Rydex S&P Index (RSP), and SPDR Gold Shares (GLD). ECB performed the best with a return of 7.25% and gold performed the worst with a return of 0.82%. ECB's performance bodes well for the Chippewa Valley local economy as it outperformed our other indexes as well as the broad S&P 500.

Figure 7 breaks down the ECB into three sectors: Retail, Manufacturing, and Other. It appears that the retail industry took a massive hit while manufacturing performed extremely well. However, it is important to first examine all of the stocks being held in the ECB before drawing conclusions. Borders Group (BGP), a retail company, went bankrupt in February. Likewise, Silicon Graphics (SGI), a manufacturing company, had by far the best return in the ECB. In order to more accurately compare sectors, it is important to remove the outliers. With Borders Group included in our calculation of sector performance, retail came in at a dismal -7.08% change. However, upon removing BGP from our calculation, retail's performance improved to -0.9%. Similarly, under our initial sector calculation, manufacturing was up 17.06% for the quarter. However, with the exclusion of SGI from our calculation, manufacturing was only up 7.2%; which is much more in line with the rest of the sectors in the ECB.

Figure 8 shows the top performing companies in the ECB. The clear winner in the ECB in quarter one was SGI, whose value rose by nearly 200%. In researching what happened to the company during the past several months, one main reason attributed to the company's success. On March 25th, SGI announced a contract win with the Korean Air Force, who has begun using SGI computing systems for weather forecasting. Although the details of the deal were not announced, the good news of the contract shot the company's stock price up 12% in one day followed by continued success thereafter.

Figure 9 displays the worst performing companies in the ECB. Losing almost 75% of their value, Borders poor performance in quarter 1 was due to the fact that the company declared bankruptcy during February of this year. The company stated that they were going to restructure and close one-third of their stores. Their future remains unclear, but during the first quarter of 2011, they were by far the worst performer in the ECB.

## Data Sources

All data and information was obtained from Yahoo! Finance and individual company websites

## Gold Counter Cyclical?

### The Market Hypothesis

For years investors have thought of gold as a "safe haven" when stocks and bonds are performing poorly, thus it is commonly referred to as being counter-cyclical to the broader stock market. We will test this theory by comparing gold returns against the stock market from 1975-2010. We will try to explain the price movement in gold and attempt to uncover the cause of this price movement.

Figure 10:

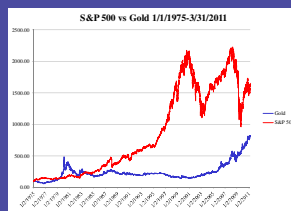


Figure 11:

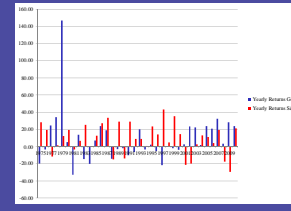


Figure 12:

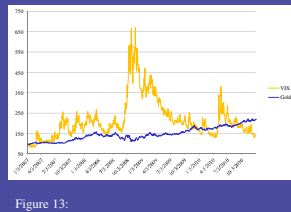


Figure 13:

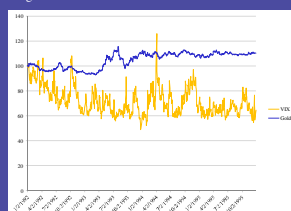


Figure 10 shows the returns of gold graphed against the S&P 500 from 1975 through 2010. At first glance it is unclear if gold is counter cyclical based on this graph. Figure 10 has three distinct time periods that should be discussed separately. First, from 1975-1980 gold returned 219% while the S&P increased 54%. Next, from 1980-2000 gold returned -49% compared to a return of 1,119% by the S&P 500. Finally, from 2000-2010 gold returned 392% compared to -18% by the S&P. This shows that for the majority of this time period the return of gold was in fact counter cyclical to the return of the S&P 500.

Figure 11 shows the yearly returns of gold and the S&P 500. This graph allows us to look at the behavior of gold on a year by year basis instead of the broader time periods used in Figure 10. Of the 36 years we tested, gold moved counter cyclical to the S&P in 18, or exactly 50%, of the years. (A counter cyclical year is one in which gold's return was positive or vice versa). This graph suggests that gold may not be as counter cyclical as Figure 10 seemed to show.

Figures 12 and 13 attempt to explain the price movement in gold based on market volatility rather than the "counter cyclical hypothesis." VIX is an index which measures the volatility of the S&P 500 with an increase representing higher volatility in the stock market. Figure 12 shows the price change in gold and VIX from 2007-2010. These four years represented a period of extremely high volatility and corresponded with a 118% return in gold. In contrast, Figure 13 examines the years 1992-1995, a time of much lower market volatility. This period of lower volatility corresponded with a 10% return in gold, significantly lower than gold's return during the time of high volatility. These two graphs show that much of gold's price movement might be explained by volatility rather than a strict "counter cyclical hypothesis."

**Conclusion-** We conclude that gold is certainly somewhat counter cyclical in nature. However, we feel that a more accurate description of gold's performance would be to say that it is a "safe haven" for investors when the markets are extremely volatile, not just when stocks are performing poorly.

