

Major Markets Letter #5

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Reverse lunch and the January effect

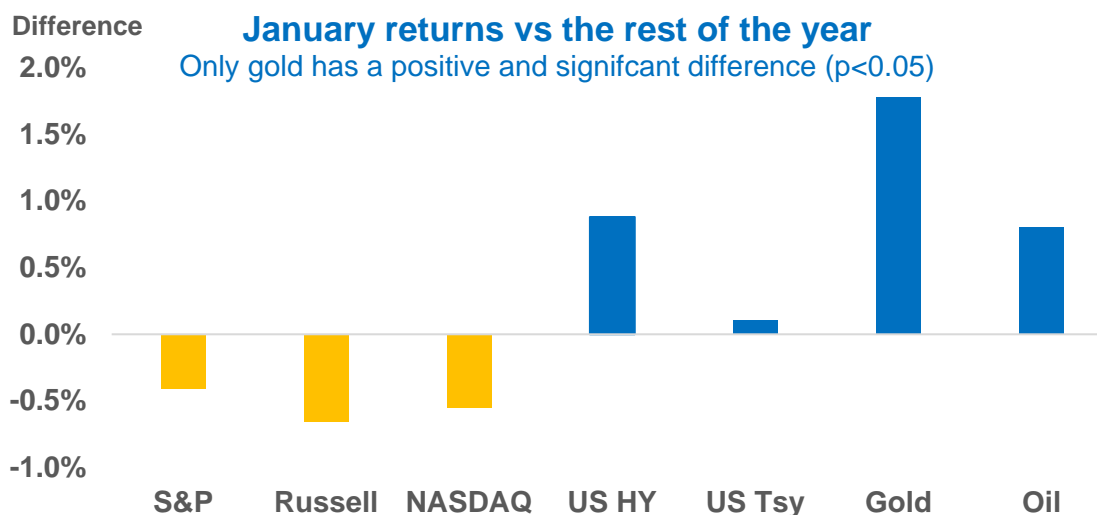
We weren't entirely sure what a *reverse lunch* was either. A quick internet search delivered "reverse lunge" instead - which may well describe what one does after the reverse lunch.

Allegedly, a reverse lunch starts with dessert and works backwards through the menu. There's liberal use of wine, cigars appear at the beginning rather than the end, and... you get the picture.

The reverse lunch is the antithesis of - or, depending on your perspective, perhaps the antidote to - *Dry January*. Type that into Google and you're greeted with detox plans, gym offers, and earnest promises of a better version of yourself.

Last week - our first back in the office after the holidays - we were discussing the *January effect*: the idea that asset performance in January is a good guide to how the rest of the year will go. One thing's for sure - January is a busy month for issuance and every dealing room wants to hit the ground running.

Some of the older members of the team (ahem) recalled old-school seasonal effects - year-end distortions in money markets, issuance cycles in credit, and how tax and fiscal calendars in the US and Japan used to move flows.



Source: Bloomberg. Total returns include price change and income from dividends/coupon

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The vague memory was that markets often felt a little more “risk-on” at the start of the year but we are also aware of the academic view, that these calendar quirks should fade away as markets become more efficient. We suspect that the January effect is mainly an equity market phenomenon, confined to certain sectors, styles and regions (Sidney Wachtel, 1942).

So we decided to test it. We pulled 30 years of monthly data for a mix of major assets:
S&P 500, Russell 2000, Nasdaq 100, US high yield, US Treasuries, gold and Brent crude.

We then compared January returns with the average of the other eleven months. If January really is special, it should show up in the differences identified in our chart.

The results were... not what many of us would have expected.

On average, all three equity indices actually do *worse* in January than in the rest of the year, including the Russell 2000, which includes small companies and is often thought of as the most “January-sensitive” index.

Gold, however, stands out strongly. Oil and US high yield also show positive January effects, while Treasuries are slightly positive but not by much.

Statistically, gold’s January outperformance is meaningful, and US high yield’s is too - though it has weakened over time. When we extend the data back 50 years, high yield’s January effect was much stronger, which is a nice illustration of how markets gradually arbitrage these patterns away.

So why gold and oil?

Gold has long shown seasonal strength around the turn of the year. Some of that used to be driven by cultural buying - Diwali, Chinese New Year - but today it’s probably more about something simpler: uncertainty. Trade tensions, geopolitics, and policy risk continue to make gold attractive as a store of value. It seems to have been going up in price, whatever.

Oil is harder to pin down. Traditional seasonal drivers like winter heating demand or summer driving are now small compared with the impact of geopolitics and supply shocks. In that world, January can sometimes just be when risk gets repriced.

High yield credit has also historically had a strong January, often linked to new issuance, portfolio rebalancing, and fresh risk budgets - though again, the effect has been fading as markets have become more efficient. A possible explanation is that high yield credit is a market with greater idiosyncratic risk, which has been managed more effectively over time.

So yes, there *is* some evidence of a January effect - just not quite where people expect to find it.

Which brings us back to the real dilemma: whether our commitment to Dry January is strong enough to politely decline the invitation to a reverse lunch.

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