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Keith Schaefer
Editor



The “January Effect” This Year Might Be THE ONE You Don’t Want To Miss

Will Your Portfolio Be Ready?

By Keith Schaefer
Publisher, the *Oil & Gas Investments Bulletin*

The holidays aren't just about getting your presents bought, wrapped and put under the tree for Christmas.

There is something else every investor needs to take care of sooner rather than later. It's the time to get your portfolio properly positioned for the New Year.

That's because this coming January may be setting up to be an exceptional month for some of 2013's worst performing stocks.

2013 has been another year where once again the Canadian stock market has been significantly outperformed by its American counterparts.

[See chart below]



That doesn't seem to make a lot of sense. The Canadian economy has been doing just fine.

While the S&P 500 is up almost 45% over the past two years, the TSX index is up less than 10%. That isn't a small difference in performance. That is a trouncing.

The underperformance over the past year is far more significant than this for many small and mid-sized Canadian energy stocks.

Many of these companies are trading at fractions of their all time highs. Some of these companies deserve the kicking the market has given them, but many of them don't.

At some point this underperformance has to end, and when it does the unjustly beaten down names will come roaring back faster than we could imagine.

It is time to get ready for that rebound.

The January Effect

For years, one of the most reliable phenomena in finance has been the January effect.

The effect, which has been documented by investors for decades, shows that small stocks, and those that have suffered and declined in price in the prior year, tend to outperform larger, stronger stocks in January.

There have been numerous studies validating the existence of the January effect.

Jeffrey Hirsch of the Stock Trader's Almanac looked at 38 years of data from 1974 to 2012 and found that a portfolio of small-cap stocks hitting 52-week lows in mid-December outperform the NYSE Composite Index by an average of 9.5% between late December late January.

That isn't a 9.5% outperformance during the following year. That is a 9.5% outperformance over that short period of time from mid-December until late January.

Hirsch also found that this outperformance was quite predictable as the portfolio of small-caps have outperformed the NYSE Composite in 33 of the 38 years examined.

Another study by professors Eugene Fama and Kenneth French found that between 1927 and 2009, the lowest market-cap decile of stocks performed eight times better in January than the average of the 11 other months of the year.

The January effect may be the closest thing to a free lunch that the stock market provides.

There are a few reasons that explain the January effect and why it is real:

- *Tax Loss Selling* – At the end of each year investors sell off stocks that have declined to create losses for tax purposes that can be used to offset gains.
- *Window Dressing* – Fund managers will often clear the dogs out of their portfolios for the December 31 reporting deadline so that they don't have to explain to investors why they are holding such losers.
- *January Selling Of Winners* – While investors make sure to sell losers in December they also defer selling winners until January, thereby delaying the recognition of a gain for tax purposes into the next year. The proceeds from the sale of these winners is often redeployed into bargain opportunities found in previously underperforming stocks.
- *January Is Bonus Season* – It is simple but true, a lot of investors receive annual bonus payments in January and a good chunk of that cash finds its way into the market.

The January effect is real and it makes perfect sense that the more severe the prior year beating was the stronger the rebound in January is likely to be.

The end of year selling is like a weight attached to the string of a helium balloon. Once the weight is taken off, the balloon is free to rise.

For the small and mid-sized Canadian Energy stocks that weight attached to the string has been a heavy one.

To take advantage of the January effect, and potentially a big one this year, that means investors need to place their bets soon.

While everyone else is setting their minds on cruise-control heading into the holiday season, this may actually be the time of year to bear down and get serious about finding the right stocks to own in advance of the January effect.

- Keith Schaefer

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