


## Is Santa Claus "rally" coming to town?



## Microscope

Since the year of 1964, stock market in the US has performed well around Christmas, or being called Santa Claus rally. The last eight trading days of December and the first three of January have been positive for equity investors on the S&P 500 returning 2% on average. Although there is no guarantee that Santa Claus rally will happen this year, the historical research is encouraging. Considering the entire 80 years of S&P 500 data, only two years witnessed a decline of greater than 10%: 1931 and 1969. Conversely, a number of years have seen exceptional gains: 10 Santa Claus rallies out of the past 80 years produced gains in excess of 10%. Five of those rallies happened during the grim 1970s. In addition, over the last 40 years, the average gain from November 20 through the end of January has been 4.2%. Furthermore, the volatility in December's year-to-year returns, especially in the US, greatly reduces, if not eliminates, any statistical confidence one can have that December will be a good month for the stock market. The low volatility may be due to holiday mood around Christmas, and speculators may avoid playing "games" during this period with little trading volume. 

The US benchmark stock index, Standard & Poor's 500 Index, has risen 63% from a 12-year low in March, closing at a 14-month high on Dec. 14. In fact, lower interest rates, cheaper homes and a homebuyer tax credit are bolstering a housing market that contributed to the worst economic slump since the 1930s. Although the recent rally was dampened by the rebounding dollar, the upward earnings revisions for the coming fiscal year will soon be priced in the stockmarket after the end of 2009. Obviously, the improvement of employment market has contributed a lot towards year-end rally. Payrolls fell by 11,000 last month, the fewest job cuts since the recession began in December 2007, according to the US Labor Department released during the first week of December. The unemployment rate in November fell to 10% from a 26-year high of 10.2% in the previous month. As a matter

of fact, a slowdown in the pace of job cuts and higher stock prices are boosting consumer sentiment. The Reuters/University of Michigan's final gauge of December consumer confidence on Dec. 23 is projected to climb to 73.7, its highest level in almost two years, from 67.4 in November. In addition, the National Association of Realtors is expected to report Dec. 22 that purchases of existing homes rose 2.5% in November to an annual pace of 6.25 million, the highest level since February 2007, according to the bloomberg's survey median. The Commerce Department on Dec. 23 may also report sales of new homes rose 1.9% to a 438,000 annual pace last month, the fastest since August 2008. However, gains in the housing market may prove uneven as foreclosures mount. Some 306,627 properties received a default

or auction notice or were seized by banks last month and a similar number is expected for December, according to Irvine, California-based RealtyTrac Inc. Consequently, seven US banks were seized by regulators, bringing this year's total of failed lenders to 140 as financial companies are tested by the recession. The agency is overseeing the dissolution of banks at the fastest pace in 17 years. Nevertheless, New York Stock Exchange trading surged to a record 3.15 billion shares as derivatives expiration and changes to the Standard & Poor's 500 Index lifted volume to more than double this year's average. Bespoke's survey of investor sentiment showed that 42.1% of respondents were bullish while only 28.4% were bearish, the lowest since May 2008. The bull to bear ratio of 1.48:1 is the highest since July. 

### MARKET BRIEFING


#### YTD % (local curr)

<b>US DJ</b>
10,328 (17.7%)
<b>Nasdaq</b>
2,211 (40.2%)
<b>Euro Stoxx 50</b>
2,871 (17.1%)
<b>HSI</b>
21,175 (47.2%)
<b>Japan NK225</b>
10,142 (14.5%)
<b>China Shanghai Composite</b>
3,113 (71.0%)
<b>Singapore</b>
2,802 (59.1%)
<b>India BSE30</b>
16,719 (73.3%)
<b>Brazil BOVESPA</b>
66,794 (77.9%)
<b>Aus All Ord</b>
4,671 (27.7%)
<b>US-10yr Bond</b>
Yield 3.54%


As at 18/12/09

## Insight: "Yield Pickup Strategy"

Yield pickup strategy means a typical transaction in which bonds, with lower yields are swapped for bonds with higher yields. It is also called yield pickup swap. The swap is usually a risky investment strategy. Investors using this strategy expose themselves to higher interest rate risk since higher yielding bonds will have a longer term to maturity. In addition, high yielding bonds are usually of lower credit quality, thereby exposing the investor to higher default risk. Some mutual funds adopt a strategic approach in continually seeking opportunities to enhance yield through spread trading and

switching. The investment process is very similar to management of bond portfolios, initially analyzing central bank policies, economic and financial market research and then determining the portfolio strategy. The key criteria in the decision-making process are usually monetary policy and overall financial conditions, economic growth expectations, credit spread premiums and credit analysis of specific issuers, implied forward market rates relative to fair value measures, and yield curve structure. Each of these criteria is continually examined to determine turning points in interest rates so as to enhance the effectiveness of the yield pickup strategy. On the other hand, many investors borrowed US dollar to invest the surplus in high yield currencies, like AUD, to capture the yield spread too. 

## A-Z Financial Tools

**Yield curve risk** is the risk of experiencing an adverse shift in market interest rates associated with investing in a fixed income instrument. The risk is associated with either a flattening or steepening of the yield curve, which is a result of changing yields among comparable bonds with different maturities. Investors holding fixed income instrument may be exposed to yield curve risk. 



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