12 MONTHS OF GREED:

When to Buy Each Stock in the S&P 500

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By Michael Carr

SEASONS are a part of nature, and of life.

Farmers in the Northern Hemisphere plant crops in the spring, and harvest in the fall, because that's when the weather is favorable.

It's the opposite pattern in the Southern Hemisphere. While technology can help increase the yields on crops, it can't change the times of the year when the crops will flourish (at least not yet).

These patterns have led to predictable cycles in agriculture. Financial markets based in agricultural products follow those patterns.

But this dynamic doesn't stop in agriculture.

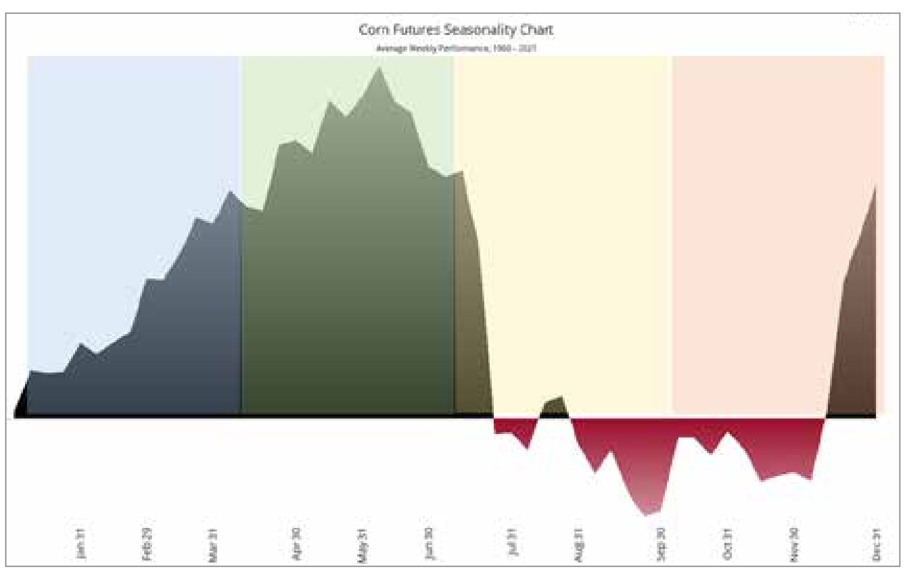
There are seasonal patterns all across the financial markets. When you know what to look for, you can gain an edge in predicting what'll happen next in a number of different sectors.

Strong predictability gives investors an opportunity to time their trades accordingly for a chance to profit.

In this report, I'll show you how to recognize some seasonal price trends and how traders tend to profit from these annual reoccurrences. Then, I'll reveal the exact process you can use to identify seasonal patterns in stocks for yourself.

Spotting Agricultural and Retail Patterns

First, let's start with a look at the seasonality of a staple crop. The chart below shows the seasonal trend in corn prices. It includes 51 years of data and averages the price changes for each week over that timeframe.



As we exit winter and head into spring, corn futures start to rise. This is the period when farmers are planting crop for the fall harvest. We generally see a bullish trend in prices as farmers prepare for the fall harvest.

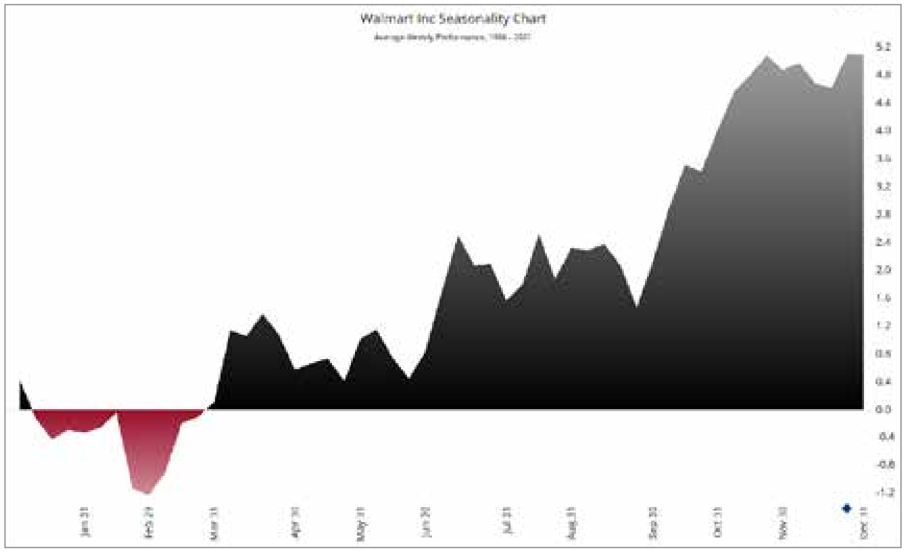
By July, famers have a good idea of how the crop will look, so futures prices stabilize. There's an old saying in farm communities that corn should be "knee-high by the Fourth of July" to provide for a profitable season.

With new fertilizers and advances in every aspect of farming, corn is often much higher than that. But farmers and analysts have a guide at that time as to what they should see in the fall harvest. This knowledge tends to pressure prices.

Corn prices generally show a bearish tendency into December when supply tightens and planning for next season begins.

This type of pattern, though, isn't unique to agricultural markets. Many stocks show seasonal patterns, too. And if you really think about it, that makes sense since many businesses follow seasonal patterns.

Retailers are an example of this. Here's a look at the seasonality of Walmart's stock:



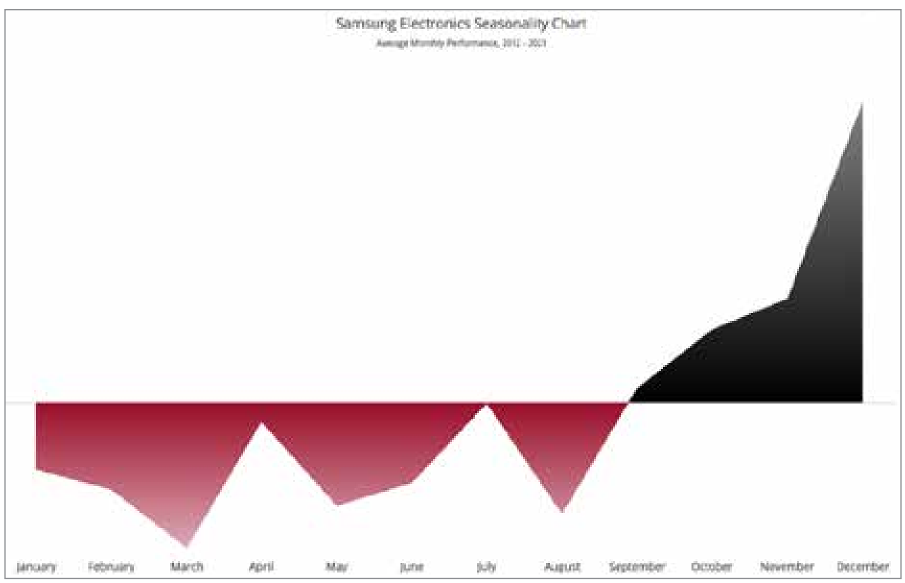
As you can see, retailers tend to make the majority of their profits in the fourth quarter — around the holidays.

Traders start bidding up shares of WMT in September as they anticipate strong holiday sales. Traders also tend to purchase shares in June in anticipation of the back-to-school shopping sprees that occur in August and September.

Profit-taking creates a bearish cycle early in the year.

Almost every stock displays a pattern like this because nearly every company has a seasonal component to its business.

These factors are found around the world, too. Take the electronics maker Samsung, for example. The following chart shows the price of the stock traded in South Korea.



There is a tendency for a rally at the end of the year as traders take positions ahead of the Consumer Electronics Show (CES), an annual tech extravaganza held in Las Vegas every January.

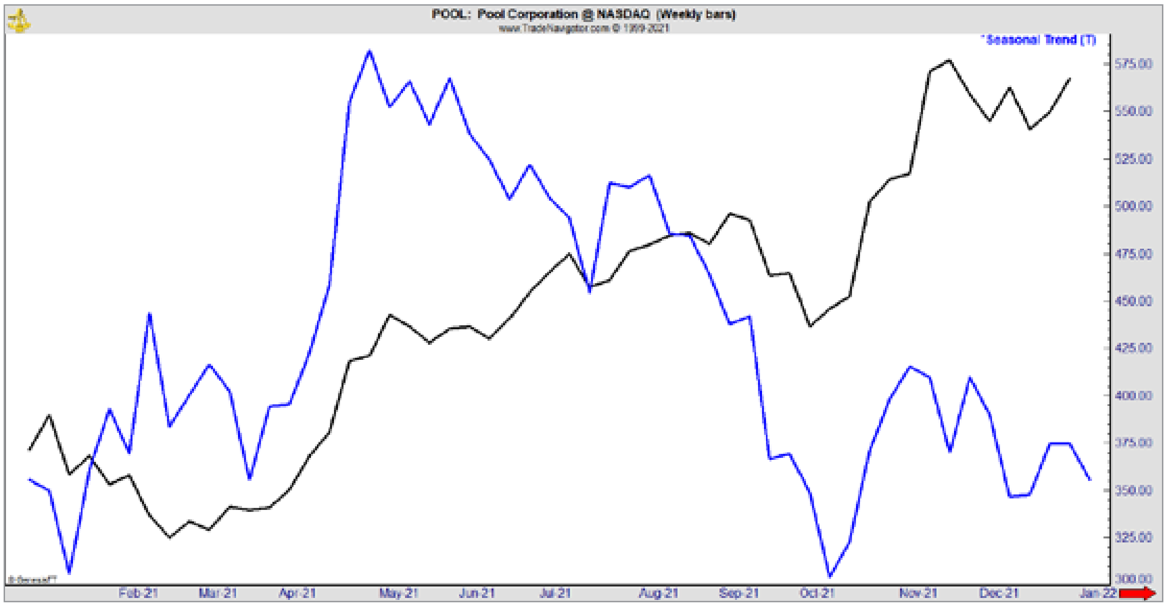
Manufacturers show their newest products at CES. Many individuals will buy the stocks of the companies with promising products like Samsung.

The smart money, however, is selling on the news and taking profits from positions it opened weeks earlier.

To uncover these patterns, you can think through the business cycle of a company. Or you can identify the seasonal trends with a math-based process…

How to Uncover Seasonal Trends with Data

For this example, we'll use a chart of Pool Corporation (Nasdaq: POOL), a company that specializes in supplying products pool owners need.



We would expect a strong seasonal pattern in a stock like this. The seasonal trend is shown by the blue line. The stock's pattern shows we should expect an uptrend from January through April, when pool owners are preparing to use their pools in the spring and summer.

The black line in the chart is the price of POOL. The price won't precisely match the turns in the seasonal trend, so the blue line in this chart should be thought of as a guide.

You can make trades based solely on that guide. To do that, look for the times of year when there are significant reversals in the seasonal trend.

For POOL, there is a seasonal bottom in January. But there is a stronger seasonal trend beginning in March and ending in late April. To trade that trend, in March, you could buy call options that expire in May. A call with an exercise price near the current stock price should provide a nice balance between risks and potential rewards.

In May, a strong downtrend begins in POOL's seasonal trend. Put options expiring in October are one way to trade that.

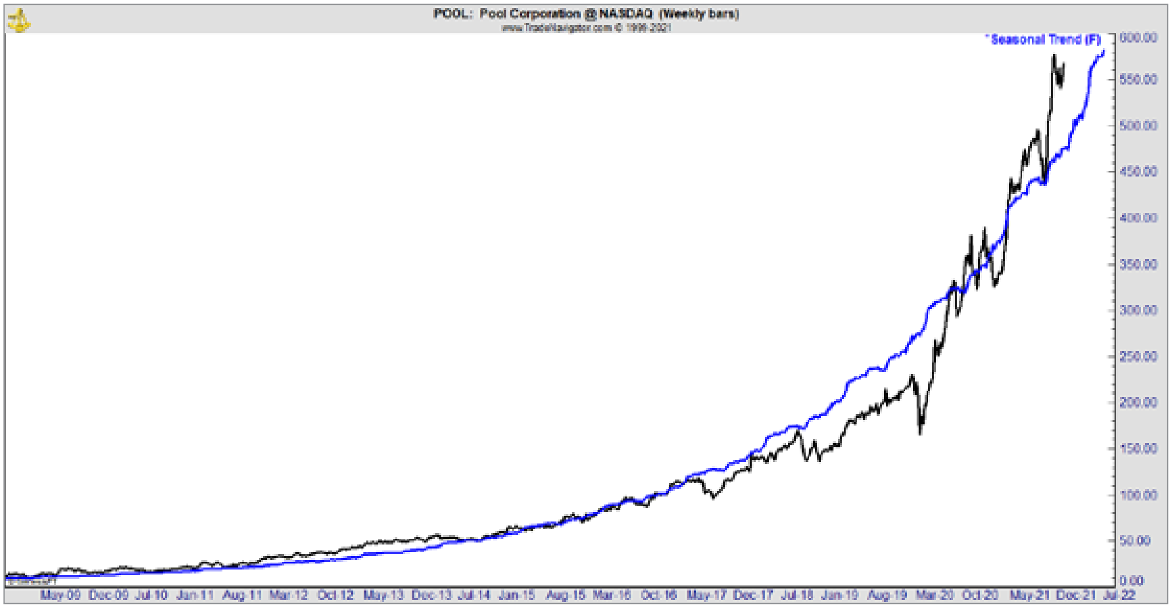
Finding that seasonal line is a meticulous process, but it's one that can provide ample trading opportunities.

Let me walk you through the steps…

To begin, collect price data for the stock. Any timeframe can be used. Monthly data is popular, but intraday seasonal patterns can also be found in many stocks. These short-term patterns are due to the behavior of traders rather than the company.

After collecting the data, you need to transform prices from dollars and cents to log values. This step removes the impact of the long-term trend in the data.

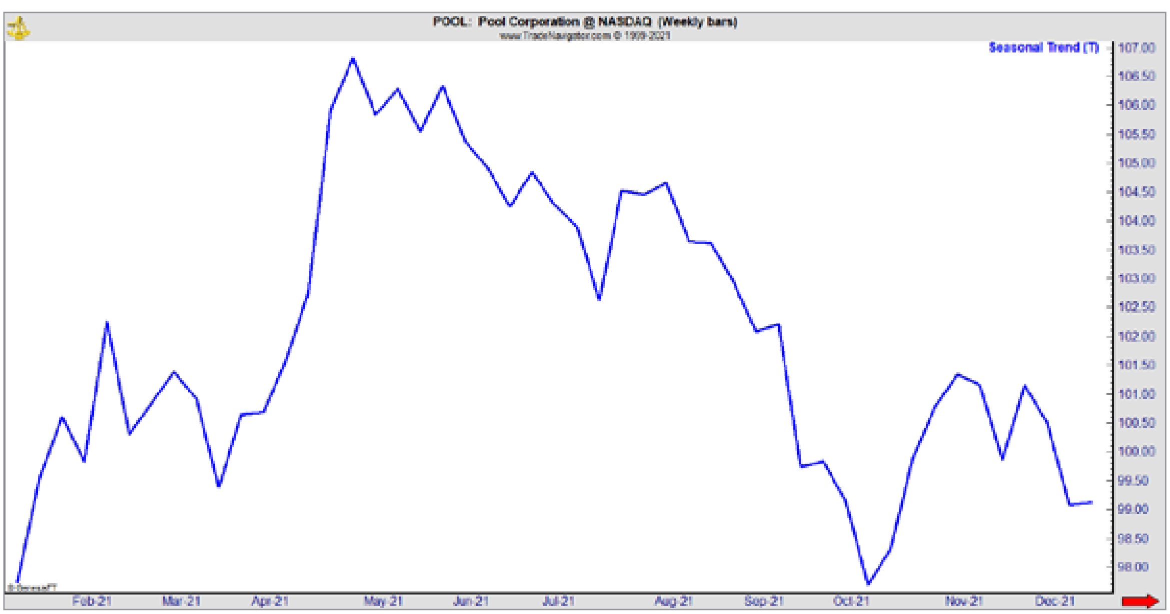
The chart of POOL below shows the difference. Using untransformed prices, the blue line just moves higher with price over the long run.



With log data, the next step is to create a periodogram. This step can be done in Excel. Enter the price data into a table like the one below.

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2012	1.53	1.56	1.57	1.57	1.57	1.61	1.57	1.60	1.62	1.62	1.62	1.63
2013	1.66	1.66	1.68	1.69	1.71	1.72	1.72	1.72	1.75	1.74	1.75	1.76
2014	1.73	1.77	1.79	1.77	1.76	1.75	1.74	1.75	1.73	1.78	1.77	1.80
2015	1.79	1.84	1.84	1.81	1.82	1.85	1.85	1.84	1.86	1.91	1.91	1.91
2016	1.93	1.90	1.94	1.94	1.96	1.97	2.01	2.00	1.98	1.97	2.00	2.02
2017	2.02	2.06	2.08	2.08	2.08	2.07	2.03	2.00	2.03	2.08	2.10	2.11
2018	2.13	2.14	2.17	2.14	2.16	2.18	2.19	2.22	2.22	2.16	2.21	2.17
2019	2.18	2.20	2.22	2.26	2.25	2.28	2.28	2.29	2.30	2.32	2.31	2.33
2020	2.34	2.32	2.29	2.33	2.43	2.43	2.50	2.52	2.52	2.54	2.54	2.57
2021	2.55	2.52	2.54	2.63	2.64	2.66	2.68	2.69	2.64	2.71	2.74	2.75
Average	1.99	2.00	2.01	2.02	2.04	2.05	2.06	2.06	2.07	2.08	2.10	2.11

After formatting the data, take the average of each column as shown at the bottom of the figure. Then, plot the averages as a line chart as shown below.



Peaks show when seasonal uptrends are expected to end. Troughs (lows on the plotted line) show when seasonal downtrends are expected to end. In the case of POOL, we have a trough in January and peak in April.

This should be the ideal time to own this stock.

During those times when the seasonal trend is bearish, traders can look for opportunities elsewhere. Aggressive traders can consider short positions or put options at those times.

Evaluating the Business Cycle for Seasonal Trends

Although we just derived this trend mathematically, the pattern in POOL could also be deduced from its business.

Let's examine it from that point now. Most of POOL's revenue is likely to be booked in the summer months, about May through September. Stock market traders are buying and selling on what they expect the future to hold.

In October and through the winter months, they are buying POOL in anticipation of the summer revenue. Then traders take profits by selling in May and the summer months because they expect lackluster performance from the company six months in the future.

Traders looking ahead, rather than at the present or the past, are driving this seasonal cycle. Many stocks have patterns like this. But we may not be able to readily explain the pattern as we can with Pool, Samsung, or Walmart.

The pattern might be related to earnings reports that occur at the same time every year. Or it might be tied to trade shows occurring at the same time every year or possibly the release of test data for pharmaceutical companies that occurs at medical conferences held at the same time every year.

If we dig deeply, we can often find the reason for the seasonal pattern…

But remember, to be a successful trader, we don't actually need to know *why* a seasonal pattern exists—all that matters is our ability to develop a trading strategy that works and that can exploit it.

In that way, this strategy is similar to something that one of the 20th century's greatest economists noted about his field of study. We would perhaps call this the Milton Friedman Trading Strategy Secret.

Friedman is probably best known by the public for his promotion of free markets. But not as well known is that the Nobel-Prize winning economist also wrote one of the 20th century's most controversial articles in economics.

In a famous 1953 paper, Friedman argued that economists shouldn't be concerned with whether their theories accurately describe reality. *Why* something exists or occurs is irrelevant—all that matters is whether your theory can be used to make accurate predictions.

Of course, some economic theories both accurately describe reality and can be used to make useful predications. That's how seasonality works in the stock market. While we can identify the *why* of the seasonal trend, we don't need to. Like Friedman said, what matters is the ability to make accurate predictions.

And although seasonality can be used as a standalone strategy, it's worth pointing out that it can be useful to confirm the pattern with momentum indicators, or trend-following tools.

Here, the strategy can be as complex or as straightforward as you choose. But adding seasonals to a strategy can be profitable, since it's based on a historical pattern that tends to repeat every year at the same time.

Benefit from Seasonality with *Precision Profits*

As a subscriber to *Precision Profits,* the trading system you're now taking advantage of *automatically* incorporates seasonality.

So if you're following my buy and sell signals, there is no additional work needed on your part to leverage this fascinating phenomenon in the financial markets.

In *Precision Profits*, we amplify the advantages of my Greed Gauge indicator by using seasonality to identify the best months to buy the top stocks currently listed in the S&P 500.

More specifically, each month I look at historical price data, creating a list of 25 companies that lets me know when each company is having its "greed month," or the month that boasts the stock's best performance for the year.

With this list, I'm able to narrow down the "best of the best" stocks—which I *then* apply the Greed Gauge to time our entry and exit.

By only buying companies when they're in their greed month, we're taking advantage of seasonality… thereby making our returns even higher.

Regards,

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