Discussion Paper

International Evidence on the "Other January Effect"

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Project Summary

Cooper, McConnell and Ovtchinnikov (2006) report US evidence of an "other January effect", where market returns in January are purported to have predictive power for market returns over the subsequent eleven months.

Preliminary research undertaken by the project leaders has found no evidence of this affect in other major world equity markets. This project will therefore examine international evidence from a wide range of countries to assess the assertion made by Cooper et al that the other January effect should become an important tool for funds managers and be incorporated in asset pricing benchmarks when assessing their performance.

Background and aims of project

Cooper, McConnell and Ovtchinnikov (2006) report US evidence of a so-called "other January effect", where market returns in January are purported to have predictive power for market returns over the subsequent eleven months. Specifically, they found that over the period 1940 to 2003, when the value-weighted market return in January is positive the return over the subsequent eleven months is an average of 14.8%, whilst the eleven-month average return is only 2.92% when the January return is negative. This statistically significant difference in returns increases when an equally-weighted index is substituted for a value-weighted index and where the analysis is conducted using excess returns rather than raw returns.

They report that this effect persists after controlling for macroeconomic and business cycle variables that have been shown to predict equity returns, the Presidential Cycle in returns, and investor sentiment, and that it persists among both large and small capitalization stocks and among both value and growth stocks. They also report that January returns have predictive power for two of the three premiums in the Fama-French (1993) asset pricing model (specifically the size and market risk premia).

Cooper et al asserts that their findings have three implications. They state that: "First, (the Other January Effect) appears to be a powerful tool in predicting the market and other portfolios and, thus it should prove to be an important tool to portfolio managers or other managers engaged in hedging market or size premium risk. In a related manner, this suggests that incorporating the Other January Effect into asset pricing benchmarks would be reasonable from the perspective of evaluating portfolio managers' performance. Finally, our results could serve to heighten the debate over the source of the risk premiums in the Fama-French three-factor model."

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Significance and Innovation

If confirmed by international evidence such as that provided by Gultekin and Gultekin (1983) with respect to the well-documented January Effect, then these implications would indeed pertain. However, preliminary research undertaken by the project leaders has found no evidence of this affect in major world equity markets such as the United Kingdom, Australia and Japan. While it is noted that different tax year ends may explain these results (see, for example, discussion in Brown, Keim, Kleidon and Marsh (1983)), there are no effects found in these countries for any other month. This in turn provides preliminary evidence to suggest that drawing the implications that Cooper et al suggest be drawn from their findings may be unsound outside of the US. Further, it casts doubt on the extent to which the US finding is other than a statistical artifact.

Description of Approach

This project will therefore examine international evidence by examining sharemarket return data for over 50 countries to assess the assertion made by Cooper et al that the other January effect should become an important tool for funds managers and be incorporated in asset pricing benchmarks when assessing their performance.. Data for some countries is available from the 1930s while for other countries data availability is for a much shorter period. The data will be obtained utilising the Wharton Research Data Services (WRDS) interface at Melbourne University for a number of databases including Datastream, CRSP and Global Insight. Other data sources such as IRESS and in the case of Australia the Australian Graduate School of Management data will be used. We will also obtain proxies for risk-free interest rates for these countries via WRDS as well as data to estimate the premia provided by the Fama-French three factor model.

The data analysis will be used to determine whether the Cooper et al result may be validly used as a tool for funds managers outside of the US and be incorporated in asset pricing benchmarks when assessing their performance.

References

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