

Seasonal Patterns in Canadian Financial Markets and the Impact of Professional Portfolio Rebalancing: Evidence of Profitable Opportunities

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ABSTRACT

Using Canadian data for the period 1957-2003, this paper provides evidence in support of the gamesmanship hypothesis. We document strong seasonality in (excess) returns of Canadian stock and government bond indices. However, the seasonality in the returns of the Canadian government bond index is opposite in direction from that of the Canadian stock indices. Seasonal strength is observed in equities, especially smaller stocks at the beginning of the year, with the rest of the year, especially the second half of the year, showing widespread weakness in relation to January. The opposite is true for government of Canada bonds, as the gamesmanship hypothesis would predict. In addition, this paper provides support of the popular expression “Sell in May and Go Away”, as the average performance of risky securities is higher in the November to April period than the May to October period. The opposite is true for government of Canada bonds. There is also support for the motto “As January Goes, so Goes the Year” and the predictive power of the January returns. Support for these popular expressions is also consistent with the gamesmanship hypothesis. Moreover, not only does this study examine the seasonal behavior of security returns (i.e., an indirect test of gamesmanship hypothesis), but data are also provided that enable us to observe directly the trading behavior of institutional investors, thus complementing the indirect tests of the gamesmanship hypothesis. We find that the stock and government of Canada bond flow of funds data employed for the direct tests of the gamesmanship hypothesis exhibit seasonality which mirrors the seasonality in the returns of stocks and government bonds, thus substantiating and consolidating the support for the gamesmanship hypothesis. The paper’s findings will be useful not only to institutional investors, but also to individual investors. Understanding the seasonal behavior of financial markets and the inefficiencies bestowed upon them by institutional factors will help investors secure higher returns and better retirement. Moreover, this paper’s support of the gamesmanship hypothesis is in line with the argument in favor of agency related factors as the key drivers of the so called value premium, namely that value stocks beat growth stocks.