

Philequity Corner (August 20, 2012)

By Valentino Sy

The Friendly Ghost

It is the Chinese Ghost Month again. For this calendar year, the Chinese Ghost Month started last Friday, the 17th of August and will end on the 15th of September. The Ghost Month falls on the 7th lunar month in the traditional Chinese calendar. According to generational Chinese folk tales, the Ghost Month is the time when ghosts and spirits access the world of the living, wandering the earth to pay a visit to their relatives, eat Chinese food, and collect ghost money.

Many Filipinos, especially the Filipino Chinese follow the ghost month traditions. They usually put on hold any activity of significant importance during this month. They normally postpone getting married, building a house, starting a new business, or even investing in the stock market.

Are Ghosts Real?

We, at Philequity, believe that this belief, whether rational or irrational, needs to be verified by empirical evidence. Are ghosts real in the stock markets? We reviewed PSEI monthly returns for the past 25 years and the results are eerily amazing and quite surreal. The fear of ghosts may in fact, be real. Our study shows that there is a very high correlation of negative returns during the lunar ghost month and the Roman calendar months of August and September. We show in detail the results of our studies.

The Ghost Month Effect

As you can see from the table below, the 7th month in the Chinese lunar calendar, has displayed a 60% chance of going down with an average monthly decline of 3%, earning the moniker “The Ghost Month Effect” from stock market participants.

Below is a table of monthly returns based on the lunar calendar for the Philippine Composite Index from 1987 to 2011:

| Lunar Month | Number of Declines (Out of 25 Years) | Number of Declines as a % of Total Sample | Average Monthly Return |
|------------------------|--------------------------------------|---|------------------------|
| 1 st | 14 | 56 | 0.5 |
| 2 nd | 9 | 36 | 1.9 |
| 3 rd | 7 | 28 | 2.4 |
| 4 th | 7 | 28 | 1.6 |
| 5 th | 11 | 44 | 0.5 |
| 6 th | 13 | 52 | 0.1 |
| 7th | 15 | 60 | -3 |
| 8 th | 14 | 56 | 0.3 |
| 9 th | 11 | 44 | -0.3 |
| 10th | 10 | 40 | 3 |
| 11th | 6 | 24 | 3.9 |
| 12th | 12 | 48 | 3.4 |

Source: Wealth Securities Research

The August and September Swoon

Based on the Roman Gregorian calendar, the month of August has also displayed a 68% chance of going down with an expected monthly decline of 3.7%. The September swoon also follows with a 52% chance of dropping by at least an average monthly decline of 1.9%.

Below is a table of monthly returns based on the Roman calendar for the Philippine Composite Index from 1987 to 2011:

| Month | Number of Declines (Out of 25 Years) | Number of Declines as a % of Total Sample | Average Monthly Return |
|------------------|--------------------------------------|---|------------------------|
| January | 9 | 36 | 2.9 |
| February | 14 | 56 | 1.5 |
| March | 14 | 56 | -0.4 |
| April | 9 | 36 | 2.2 |
| May | 7 | 28 | 2 |
| June | 10 | 40 | 2.7 |
| July | 11 | 44 | 1.9 |
| August | 17 | 68 | -3.7 |
| September | 13 | 52 | -1.9 |
| October | 10 | 40 | 1.2 |
| November | 11 | 44 | 1.4 |
| December | 6 | 24 | 4.4 |

Source: Wealth Securities Research

Ghosts and Santa

Conversely from the two tables above, we can see that while August and September are normally down months, December and January have consistently been up months. The month of December has a 76% probability of being up with an average return of 4.4%. January also has a 64% tendency to be up 2.9% month on month. Even the 10th, 11th and 12th months in the lunar calendar which usually coincides with December, January and February in the Roman calendar, have displayed a higher probability of being up with monthly returns of 3%, 3.9% and 3.4% respectively.

Who is afraid of Ghosts?

There you have it. While there's a strong correlation of negative returns during the August and September swoon, we at Philequity, would rather see these months as windows of opportunity to buy stocks. As you can see, there have been consistently positive returns during the months of December and January as well. Rather than being afraid of ghosts, investors should actually take advantage of these months so that when Santa Claus returns, they can sell them much higher and take profits. Instead of getting spooked and running away from ghosts during these two months, investors should use these dips as buying windows.

Possible Reasons to the Puzzling Anomalies

Our studies show that the correlation of the ghost month to the decline in the stock market is quite uncanny. Perhaps there may be some valid reasons to these superstitious Chinese beliefs. However, there may be some other reasons for this decline. For example, American and European fund managers take their summer vacation during the month of August, as this is the hottest month of the year in the Western hemisphere. In contrast, the Philippines get inundated by typhoons and floods during this rainy season causing widespread damage dampening investor sentiment.

On the other hand, the persistence of the cheery phenomenon during the Christmas season can be explained by end-of-year window dressing by fund managers and institutions, to pump up their annual results for their clients. Combined with the general upbeat mood during Christmas season, retail investors who have received their bonuses funnel them towards stock investments spurring the markets to go higher. This rally usually carries over to January, where a happy new year brings hope that things will be better, encouraging people to invest. *(See Philequity Corner: Santa Claus Rally and the January Effect, December 26, 2005)*

Casper the Friendly Ghost

Investors should not be afraid of the ghost months of August and September. These months deliver the perfect windows of opportunity to buy more shares of their favorite companies at a discount. The uptrend in the Philippine economy is still intact, and the reasons to remain bullish remain as valid today as in the past few months. As long as the opportunity presents itself, there may be stocks selling off without any reason, other than the dampening of market sentiment, albeit temporarily. Just as the popular cartoon character that appeared in Harvey Comics back in the 90s, we believe investors should delight and welcome Casper, the Friendly Ghost.

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