Is the TSX Index Headed for Another October Market Crash?

Description

The Canadian markets have gotten off to a rough start this October, with the S&P/TSX Composite Index having fallen 1.39% since the start of the month. The losses were particularly tough on Tuesday and Wednesday, when the index slid 393 points in just two days. For many investors, it has been a painful reminder of last October, when the TSX initiated a correction that lasted until December.

If you think you're seeing a pattern here, you're not alone. Many investors insist that October is a terrible time for the markets and have even coined a term ("the October Effect") to describe the phenomenon. Basically, this term describes a tendency for stock market returns to be weaker in October than other months. If real, this tendency might be a good reason for investors to exit the markets pronto. But is it? To answer that question, we first need to look at the alleged phenomenon in more detail.

What is the October Effect?

As started earlier, the October Effect is a purported tendency for stock market returns to be weaker in October than in other months. Proponents of the theory do not necessarily believe that the markets are headed for a 1929- or 2008-style collapse every October but do maintain that stocks will do worse on average that month.

To their credit, many of history's great crashes were indeed initiated in October. The Great Crash of 1929 famously took place in October, as did the Panic of 1907 and 1987's Black Monday. These examples seem to give October more than its fair share of historically notable crashes. But does that actually mean that the month has weaker returns than average?

Is it real?

To answer whether the October Effect is real or not, we need to look at the average returns in the month of October and compare them to other months. After all, it could easily be that all the "big name" October crashes are oft-mentioned *because* October Effect proponents constantly talk about them —

similar to the “27 Club” phenomenon in music or the discredited “Bermuda Triangle” shipwreck theory.

When we look at the data, we see mixed results.

According to Yardeni research, October saw an average return of 0.4% between 1928 and 2018. That’s lower than most months but actually higher than September, May, and February. According to this data, October is the fourth-worst month for stock market returns, while September is the worst. This data does not exactly contradict the idea that October is a bad month, but it doesn’t support the claim that it’s the absolute worst one. Other research *does* support the theory that October is the most *volatile* month for the markets, but volatility isn’t the same thing as poor returns.

What to do

If you still think that the October Effect theory might have a grain of truth to it, you have some options available. And no, I’m not talking about pulling all your money out in a panic; October’s average returns are low but still positive, so avoid the urge to panic sell.

Instead, you might want to re-balance your portfolio toward “safe” stocks like **Fortis**. Fortis is a popular utility stock with a history of doing well when the markets are doing poorly. When markets take a downturn, investors rush toward utilities as a safe haven. The main reason is that utilities provide an essential service (heat and light) that people can’t cut out, even in the worst times.

Fortis provides power to 3.3 million customers in Canada, the U.S., and the Caribbean, providing it with a large and growing rate base. With an uninterrupted 46-year track record of raising its dividend, it is one of the most financially stable companies in Canada. And with a present yield around 3.4%, it’s a great income play for long-term, defensive investors. Overall, it’s a great pick to keep the October jitters at bay.

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