Is a Santa Claus Rally Right Around the Corner?

Description

The Santa Claus Rally refers to the stock market's tendency to rise after Christmas Day and into the start of the new year. Will we experience a Santa Claus Rally this year? Should investors even invest with the potential of a Santa Claus Rally in mind?

My quick answer to the first question is that it doesn't matter, because the rally, which usually lasts about a week, is too short a period for investing. Perhaps traders might hop on the train if they think there will be a rally. I think I just gave a crude answer to the second question, too.

More important things than a Santa Claus Rally

The Santa Claus Rally is only about a week. That's not enough time for any business to prove itself. Therefore, investors shouldn't get into stocks with the hope of a Santa Claus Rally. Rather, focus on the fundamentals of the underlying businesses you're interested in as well as the valuations of the related stocks.

Generally speaking, it's a good idea to look at businesses three to five years out. That gives enough time for the businesses to prove themselves.

That said, if the stock market accidentally bids up a stock to be fully valued or even overvalued, you could choose to sell some or even all of your shares, depending on your financial goals and portfolio composition.

The stock market will tend to oversell or overbuy stocks — it's swayed by emotions. If investors can take advantage of the market's emotions of fear and greed, they can boost their returns.

When to buy your favourite stocks in a market crash

For example, during the market crash earlier this year, **Royal Bank of Canada** (TSX:RY)(NYSE:RY) stock sold off about 30% from peak to trough. Yes, even a large-cap, blue-chip, dividend stock like

Royal Bank can have deep selloffs when the market is in fear.

You did not need to time the bottom. Just buying RBC stock on the correction would have allowed you to lock in a relatively higher dividend yield than normal. The leading bank stock's safe dividend and usually stable and growing earnings are what characterize it as a low-risk investment.

If you wanted a safer entry point, you could have waited for the stock to finish falling and consolidate sideways for some time before buying. Using this strategy, you could have accumulated shares in the $83-87 per share range for an elevated yield of about 5%. And your position would have appreciated about 23%.

The stock market was raining opportunities during the market crash. There were tonnes of other stock ideas that could have gotten you much richer if you had the cash to invest.

Never mind a Santa Claus Rally

Currently, I think it's time for caution. The stock market had already recovered and rallied strongly from the market crash bottom. First, it adjusted to the new normal of the pandemic. Second, positive vaccine news and the commencement of the global distribution of vaccines pushed the rally further.

However, the market hasn't factored in the potential of hiccups in vaccine programs, nor how much of the global population will accept the vaccines. Experts say that at least 70% or higher of a population needs to be immune to the virus in order for herd immunity to take effect.

Herd immunity essentially protects the entire population, even children who can't take a vaccine. To be immune, an individual either needs to take an effective vaccine or be infected and develop antibodies.

The Foolish takeaway

Whenever investing in stocks, make sure you focus on the business fundamentals. If it's a dividend stock like RBC, you want relatively stable and growing earnings and a sustainable payout ratio that keep the dividend safe.

If it's a growth stock, it should be growing earnings or revenue at a rapid pace, and you have reason to believe that it will continue that trend over the next few years.

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kayng