September Effect: Is a Market Correction Coming?

Description

This September, stocks are looking pretty pricey. The post-COVID stock market rally has taken all major North American indexes to new highs, and valuations have crept up along with the averages.

Amid such an environment, it's natural to wonder whether a correction is around the corner. Historically, there's some precedent for thinking that one might be. In this article, I'll explore that historical precedent in detail, and examine whether it justifies giving your investments a second thought.

September has historically been the worst month for the markets

One historical factor that argues for a market correction this month is the September Effect. Historically, September has been the worst month for stocks, with a mean -0.4% return. While the "October Effect" is better known, the September Effect actually has a more statistical basis. Historically, October has delivered positive returns, September hasn't. Does that mean that *this* September will be a loser? No, but when we consider that the Buffett indicator and other metrics like index P/E ratios suggest overvaluation, we've got some basis for concern.

Is a correction is coming?

Certainly, there's a basis for thinking that a market correction could happen this month. A crash can happen at any time and this month is historically a bad one for the markets.

This is particularly the case for U.S. stocks. If you look at a U.S. stock fund like the **Vanguard S&P 500 Index Fund** (TSX:VFV)(NYSEMKT:VOO), it's based on the exact same 500 stocks that the -0.4% return mentioned above was calculated on. If history is any indicator, then this index fund has some risk of seeing a correction this month. Of course, past performance doesn't indicate future performance. You never know what direction things are going to go in. But with the **S&P 500 Composite Index** trading at 35 times earnings in the midst of the worst month for stocks, you've got to pause for at least a moment to consider what could happen.

As for Canadian stocks, the matter is harder to discern. I wasn't able to find any ready data on this as I did for U.S. stocks. However, after a quick glance at stock charts for the **iShares S&P/TSX 60 Index Fund** (TSX:XIU), I was able to determine that, over the last five years, the TSX had negative returns in two Septembers and a 0% return in one:

- September 2020: negative return.
- September 2018: negative return.
- September 2016: approx 0% return.

This suggests that XIU does tend to perform relatively poorly in September. And, like VOO, it is trading at a historically high earnings multiple. So, a correction could easily be in the cards for XIU in September.

Foolish takeaway

As we've seen in this article, September is historically a weak month for stocks. It's the weakest out of all 12 months, in fact, a trend that trend holds over a number of different time frames.

Does that mean that you need to pull your money out of the markets though?

Hardly. Studies show that time in the markets beats timing the market. Hyper-active investors often think entering and exiting stocks is a good idea, but few can pull it off consistently. Overall, the long game is the best one to play.

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