BefinLab

THE RESEARCH LABORATORY FOR BEHAVIORAL FINANCE

Press news

BEFINLAB INDEX.
BEHAVIORAL FINANCE FUNDS EXPLOTING THE DECEMBER EFFECT

BEFINLAB INDEX PROVED TO OUTPERFORMED S&P AND EUROSTOCK IN DECEMBER 2011.

BefinLab (Research Laboratory for Behavioral Finance) launched its BefinLab Index to track the performance of the most important Behavioral Funds active in the market versus their relative benchmark, the S&P index, the Eurostock.

The index considers 25 funds, which managed a total $12bn, that claim to apply behavioral finance in their portfolio strategy. We analyzed their performance from November 27th to December 28. BefinLab index, in the period considered managed to outperform S&P by 17bps and the Eurostock by 121 bps demonstrating the capacity of the Behavioral Funds to exploit the so called December effect.

The December seasonality effect

There are several studies on seasonality effect in equity market. In a recent report Goldman Sachs analyzed the European Stock market going back to 1974. They verified that *"December stands out as one of the best months for equities, using both long- and short-term data. In years when the first 11 months have yielded good returns, December has tended to be particularly strong. Based on monthly European Equity data going back to 1974, December has on average returned twice as much as the monthly average (1.7% vs. 0.8%). It is the second best month based on median data"* (Goldman Sachs 19 November 2011, Strategy Matter, The December/ January Effect). The explanations of this seasonality are variegated. Among the ones most known is

the fact that this may be because of increased sales and earnings due to the Christmas season, or because of expectations for new products at the start of the next year. In an article published by Santoni and Kelshiker (2010) analyzing the performances of a sample of 31 Behavioral Funds it has been highlighted that on average these funds are able to capture this phenomenon and in December and January on average they tend to perform better than the benchmark. Grinblatt and Keloharju (2001) identified also an arbitrage opportunity, linked to tax related selling, arising in December that tend to favor "smart investors". They found out that in December investors are more likely to sell extreme losers (to gain a tax credit) and substitute them with extreme winners than they are during the rest of the year as such identifying a strong December bias that could be easily exploited by behavioral finance followers.

The index and the portfolio strategy

The sample is composed by 25 funds of which 72% large cap funds, 28% small cap/multi cap. Their style is for 40% value based, 12% growth and 48% blend. The region of focus is for 68% North America, 24% Europe and the rest Asia (4%) and Develop markets (4%).

Portfolio Managers that apply behavioral finance in their investment strategy implicitly accept that excess profits are possible if the inefficiency is recognized and analyzed properly because investors behave irrationally at times and the behavior is reflected in the market price. Analyst and Investors are believed to be slow to recognize new information related to earnings surprises behaving overconfidently to their prior view with a tendency to underweight evidence that disconfirms their prior views and to overweight confirming evidence. The two main biases at the base of portfolio managers theory was overconfidence and anchoring. The most common tool used to take advantage of this inefficiencies are the exploitation of the so called winner lose effect, the trend momentum effect, the post earning effect and the insider dealing as information signal.

The Research Laboratory for Behavioral Finance BefinLab was established in 2010, as the result of the joint effort of some professional traders and research scholars to promote common initiatives in the field of behavioral finance, which requires the interaction and the collaboration among experts of different areas of knowledge and specialization.

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TAB. 1. PERFORMANCE ABSOLUTE % DECEMBER 2011