

# Buy Calls on the Russell 2000<sup>®</sup> (RUT<sup>SM</sup>)—Anticipate “January Effect”

## Situation

In this example, assume it is November and the Russell 2000 (RUT) Index, which is composed of small-cap stocks, is priced at 480.

## Outlook

You have done extensive research on the January Effect (see Bibliography on page 03) and believe that recent selling of stocks due to tax losses and holiday spending has created a bullish outlook for small-cap stocks in upcoming weeks. You would like to participate in upside moves of small-cap stocks but minimize your downside risk exposure. You also would like to avoid the transaction costs involved with buying and selling thousands of small-cap stocks.

## Possible Strategy

Buy 30 January at-the money RUT call options priced at 20. Your total cost for the premium, with the \$100 multiplier, is \$60,000.

## Discussion of Options Position

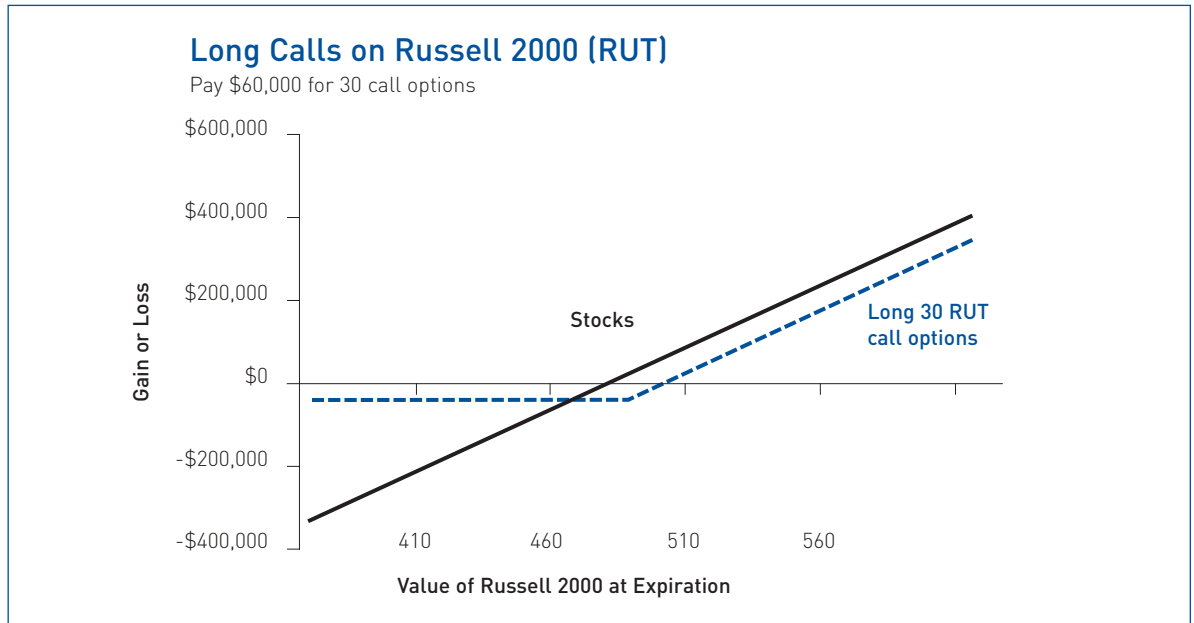
Here are a graph and table showing the approximate profit-and-loss for a long option position of 30 RUT call options, and for a \$1.44 million basket of small-cap stocks roughly matching the Russell 2000. For more information on options on the Russell 2000, please visit <http://www.cboe.com/rut>

RUT Price at Expiration	Profit/loss on Long 30 RUT Calls	Profit/loss on Stocks Bought for \$1.44 million
400	- \$ 60,000	- \$ 240,000
440	- \$ 60,000	- \$ 120,000
480	- \$ 60,000	\$ 0
520	\$ 60,000	\$ 120,000
560	\$ 180,000	\$ 240,000

All values shown above are at the time of expiration.

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A long call option strategy can appeal to bullish investors who would like to participate in upside gains but want limited downside risk. In a long call strategy, your maximum loss is limited to the premium paid for the options (in this case, \$60,000). Theoretically, there is no limit to how high the underlying index will rise, therefore making the profit potentially unlimited, minus the premium and other costs paid.

**Discussion of The January Effect**

The “January effect” refers to the phenomenon in which many securities, and particularly stocks of smaller companies, have enjoyed higher rates of return in January than in any other month. The effect was first suggested in 1942, and widely publicized in the past 25 years by scholarly articles and a popular book entitled *The Incredible January Effect: The Stock Market’s Unsolved Mystery*, by Robert A. Haugen and Josef Lakonishok. From 1926 through 1989, the smallest 10% of all stocks (or “10th decile”) beat the rest of the market by an average of 9.4 percentage points in the month of January. Perhaps due in part to publicity and anticipation of the effect, the effect weakened slightly in the 1990s, but small stocks still outperformed by an annual average of 5.8 percentage points.

Some evidence suggests that, in the past decade, some investors might have purchased small-capitalization stocks in December in anticipation of the January effect—for example, the price of the Russell 2000 index of small-cap stocks rose in every December from 1987 to 2000.

There are a number of theories as to why the January effect has occurred. Some people speculate that it may be related to the many year-end research reports on the small-cap market, which can make these stocks look like attractive places to put money. Another theory says that investors who need cash for the holiday season will sell some holdings; bargain hunters then swoop in to buy the sold-off shares. Others believe the effect may be related to tax-motivated selling and buying—fund managers might rush to buy back all those money-losing stocks they had previously sold to meet a tax-loss deadline. See the bibliography on page 03 for more details.



(DJX) Dow Jones Industrials  
 (QQQ) Nasdaq-100 Shares  
 (OEF) iShares S&P 100  
 (VIXN) CBOE Nasdaq Volatility Index  
 (VIX) CBOE Volatility Index

(SPX) S&P 500  
 (OEX) S&P 100  
 (RUT) Russell 2000  
 (NDX) Nasdaq-100  
 (MNX) Mini-NDX

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Please note that past performance is not indicative of future returns, and this does not constitute a recommendation to buy or sell securities in any month. Please consult with your financial advisor about investment advice.

### Average Monthly Price Changes 1980–2000

Month	Russell 2000 (RUT)	S&P 500 (SPX)	Dow (DJX)
January	2.70%	2.14%	2.24%
February	2.56%	0.91%	0.97%
March	0.20%	1.00%	0.98%
April	1.17%	1.29%	2.07%
May	1.87%	1.44%	1.31%
June	0.76%	1.16%	0.78%
July	-0.48%	0.80%	1.33%
August	0.37%	0.44%	0.08%
September	-0.04%	-0.46%	-0.73%
October	-1.09%	1.01%	0.61%
November	1.38%	1.56%	1.94%
December	2.86%	1.85%	1.82%

#### Bibliography of Articles on Seasonality and the January Effect

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(DJX)	Dow Jones Industrials	(SPX)	S&P 500
(QQQ)	Nasdaq-100 Shares	(OEX)	S&P 100
(OEF)	iShares S&P 100	(RUT)	Russell 2000
(VIXN)	CBOE Nasdaq Volatility Index	(NDX)	Nasdaq-100
(VIX)	CBOE Volatility Index	(MNK)	Mini-NDX

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For more information on the January effect and Russell 2000 options, please visit <http://www.cboe.com/rut>

For more examples of options strategies, please visit <http://www.cboe.com/strategies>

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