What spooks the stock market in October?

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(PhysOrg.com) -- October ushers in the fourth quarter, falling leaves, football and in some, now infamous, years, financial meltdowns. Is the tenth month of the year more prone to stock market crashes than others? Economics professor Stephen Williamson says there's little evidence to support that the next big crash will occur this month just because the last three major crashes happened in October.

"Stock market crashes have occurred sufficiently infrequently in history that there is not enough evidence on when they are more likely to occur," says Williamson, an economics professor at Washington University in St. Louis. Nevertheless, he has three theories on why the stock market might tend to crash in October.

1. Spurious Correlation Theory

"Crashes could be completely random events," says Williamson. "And if there are few of them, there is a high probability that all of them will occur in October (or April or June or whatever)."

Williamson illustrates "spurious correlation" or random events with this example:

"I could observe the behavior of 100 dogs. Suppose that I get 100 people to watch the 100 dogs for a week, and every morning just before the stock market opens, these people observe whether the dogs are scratching themselves. Chances are that I will be able to find one of these dogs - call him George - who will have scratched himself every day when the market went up, and did not scratch himself when the market went down. Now, I would certainly be considered a fool to bet on the stock market going up on days when George scratches himself. In the same way, I might be foolish to bet on stock market crashes in October."

2. Ripening Pumpkin Theory

"It could be that there is something fundamental about October that causes crashes," posits Professor Williamson. He leaves no autumn squash unturned in his pursuit of October crash theories. He dares to ask, "Could ripening pumpkins cause market crashes? Is there something in the air from falling leaves that weakens financial fundamentals?"

Alas, he concludes, "Not likely." File this theory with the ones on black cats and broken mirrors.

3. Sunspot Equilibrium Theory

Pay attention class, this one is tricky. "In some economic models, there can exist a 'sunspot equilibrium'," explains Professor Williamson. "A sunspot equilibrium has the feature that, if everyone coordinates on some observable event that does not matter in any fundamental way (like October), then this can have an influence on real events."

Before you start tweeting positive thoughts about October, read on:

"For example, it could be that, if everyone believes that October is a bad month for the stock market, then this is self-fulfilling - general pessimism drives down the stock market "for no good reason." There are some special conditions required for sunspot phenomena. This is a possibility, but I don't think it's likely."

There you have it, three theories on why crashes happen - or don't happen - in October. Professor Williamson says, if he had to choose, he would put his money on #1, the Spurious Correlation Theory. Those seeking animal spirits or complex mathematical equations to explain stock market timing may need to confer with the witches and wizards who, we predict, with a great deal of certainty, will ring your doorbell and ask for treats on Oct. 31.

Provided by Washington University in St. Louis (news : web)