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Sell in May and Go Away?

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"Sell in May and go away," However, no one ever said it was the beginning of the month. – John J. Person (CTA, professional trader, author, speaker, 6/19/2000, b. 1961)

Because of the huge influence the stock market exerts on our net worth and especially our retirement plans, you can find many sayings and quotes related to its operation. The reality is that some of the sayings and quotes make sense, others do not and probably none are ever valid all of the time. That being said, many of the adages do provide gems of wisdom in the oft-times complex world of investing. One frequently heard phrase around this time of year is the old adage, "Sell in May and Go Away".

Also known as the "Halloween Indicator", the phrase "Sell in May and Go Away" refers to a seasonal investment strategy that includes the period from November to April. This six month period typically produces better stock market returns than the six month period from May to October. The data to support this adage will be presented later in the article but the saying appears to generally be true. First, a little history.

The saying originated in England (over a century ago) and its longer version was "Sell in May and go away, do not return until St. Leger's Day. The St. Leger Stakes is a horse race in Great Britain open to three-year-old thoroughbred colts and fillies. It is run at Doncaster Racecourse in South Yorkshire, England during the month of September. In England, May is the start of summer so stock brokers and investors would often leave for vacation and not return home until September. Consequently, the stock trading was typically flat from May until September since both the moneyed gentry and the brokers did not go back to work until the end of the racing season culminating at St. Leger. In the U.S., the "sell in May" strategy was referenced as early as 1935 in an article in the *Financial Times*. In these bygone eras, there may have been legitimate reasons for the evolution of the adage, but is it still valid today in our globalized and computerized trading environment? Let's examine the data.

A huge proponent of the November to April seasonal trading strategy is the Stock Trader's Almanac. The Almanac states that investing in the Dow Jones Industrial Average (DOW) between November 1st and April 30th each year is a strategy that has consistently produced reliable returns since 1950 with reduced risk. In the alternate six month period between May 1 and October 31, the DOW is sold and switched into fixed income investments. Although February is not one of the stronger months, according to the Almanac, the November-April period has produced an average yearly return of 7.3% during this six month period since 1950. In contrast, the May-October period has only produced a 0.4% yearly return. The 6.9% difference between the two periods is a real eye opener. The S&P 500 shows similar results.

The Stock Trader's Almanac offers a further enhancement to this "Best Six Months" strategy by pinpointing entry dates in November and exit dates in May. The Almanac claims that results can almost be tripled by using this additional timing methodology. The quote at the top of the page would seem to add credence that May 1 and November 1 are not the only dates to enter and exit.

Ok, so if this strategy is so great, why don't we just use it all of the time and forget about everything else? Well, first of all, there is no strategy that works all of the time in the stock market. If there was, Warren Buffett would probably own it. The results are averages and averages can have wide deviations. I am reminded of a story I once heard that if you put one hand on a hot stove and the other hand in an ice bucket, the two should produce an average temperature for you. We all know that would only produce extreme discomfort. If an investor started with this strategy and had a bad year or two at the beginning, would they stick with it? If the stock market happened to be going up in the May to October time period when they were in fixed income, would they stick with it? Probably not. This strategy could work well for younger investors who have decades to let the averages revert to the mean. However, the typical retiree does not have those decades to wait; they must take Required Minimum Distributions as well as withdrawals for living expenses. Managing market downturns and risk are much more critical for retirees than for younger investors.

I do think there is a lot of merit to the "Sell in May and Go Away" strategy, especially if the additional timing enhancements are used. Profitable opportunities also exist in the stock market during the May-October time period but risks are higher and the returns are usually lower. In my opinion, this strategy is a good starting point but further refinements are necessary for its everyday use.

With all of the speculation when the Federal Reserve will raise and how it will affect our investments, I have included an article from the Financial Planning Association addressing this topic. You will receive this newsletter after the official Memorial Day holiday has past but let us always remember the brave men and women who have made the sacrifices for the freedoms we enjoy. Take good care and enjoy the summer as it unfolds.

Interest Rates: What's the Connection to Your Portfolio?

Here's how rising or falling interest rates could affect your investment strategies.

When it comes to interest rates, one thing's for certain: What goes down will eventually come up.

The federal funds rate --the rate on which short-term interest rates are based --has varied significantly over time. It's a cycle of ups and downs that can affect your personal finances --your credit card rates, for example. But what about less familiar effects, like those that interest rate changes can have on your investments? Understanding the relationship between bonds, stocks, and interest rates could help you better cope with inevitable changes in our economy and your portfolio

Bond Market Mechanics

Interest rates often fall in a weak economy and rise as it strengthens. As the economy gathers steam, companies experience higher costs (wages and materials) and they usually borrow money to grow. That's where bond yields and prices enter the equation.

What is yield? It's a measure of a bond's return based on the price the investor paid for it and the interest the bond will pay. Falling interest rates usually result in declining yields. As rates spiral downward, businesses and governments "call" or redeem the existing bonds they've issued that carry higher interest rates, replacing them with new, lower-yielding bonds. Why? To save money. (A homeowner refinances his or her home at a lower mortgage rate for the same reason.)

Interest rate changes affect bond prices in the opposite way. Declining interest rates usually result in rising bond prices and vice versa --think of it as a seesaw relationship. What causes this change? When interest rates rise, investors flock to new bonds because of their higher yields. Therefore, owners of existing bonds reduce prices in an attempt to attract buyers.

Investors who hold on to bonds until maturity aren't concerned with this seesaw relationship. But bond fund investors may see its effects over time.

Evaluating Equities

Interest rate changes can also affect stocks. For instance, in the short term, the stock market often declines in the midst of rising interest rates because companies must pay more to borrow money for expansion and capital improvements. Increasing rates often impact small companies more than large, well-established firms. That's because they usually have less cash, shorter track records, and other limited resources that put them at higher risk. On the other hand, a drop in interest rates may result in higher stock prices if corporate profits increase.

So why do some stocks increase in value even as interest rates rise, or vice versa? Because industry or company-specific factors --such as the development of a new product --can impact stock prices more than rate changes.

Taking Action

Is there anything an investor can do when faced with interest rate uncertainty? You bet. Although you can't change interest rates, you can assemble a portfolio that can potentially ride out the inevitable ups and downs. Risk reduction begins with diversifying your investments in as many ways as possible.

Let's start with equities. Consider investing across different sectors, because no one knows which of today's industries will fuel the next expansion. Also be aware that some sectors --such as energy --are more economically sensitive than others, which can lead to increased volatility. Additionally, consider stocks or stock mutual funds that invest in different market caps and have different investing styles, such as both value and growth investing.

On to fixed-income investments. Do your bond funds hold bonds of different maturities --short-and long term --and types, such as government and corporate? Different types of bonds react in their own way to interest rate changes. Long-term bonds, for instance, are more sensitive to rate changes than short-term bonds.

Interest rates will always fluctuate in response to economic conditions. Rather than trying to guess the Federal Reserve's next move, why not concentrate on creating a portfolio that will serve your needs well -no matter which way rates go?

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