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SELL IN MAY ... GO AWAY

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An old stock market dictum says that spring is for profit-taking, or at least a time to reduce your exposure to equities. In the classic market psychology, you "sell in May and go away" with the belief that stock prices will plateau or retreat in spring and summer, and then you return to stocks in the fall, taking advantage of bargains and factors that will encourage a hot fourth quarter.

As the following paragraphs indicate, there is sound rationale and statistical justification for this strategy, as well as some caveats... I'll let the reader decide which arguments are most compelling, but summarize at the end of this month's commentary how I decided to address this issue with client accounts last month...

The argument for "going away"

Over the last 12 months, investors who held to this belief made out pretty well. From May 1-November 1, 2011, the Dow lost 6.7%. From November 2011 through April 27, 2012, it gained 10.7%.[1,2] If we open a historical window - specifically, *The Stock Trader's Almanac* - back to 1926, we see the S&P 500 rising 4.3% on average during May-October and gaining an average of 7.1% from November-April.[3]

Unsurprisingly, *STA* editor-in-chief Jeff Hirsch is an advocate of the "sell in May" approach. So is Sam Stovall, who is of course the chief equity strategist at S&P Capital IQ. As Stovall just noted to *Forbes,* since 1945 the S&P 500 has gained just 1.2% during the average May-October run yet advanced 6.9% during the average November-April period.[1,3] While these numbers are pretty compelling, you know what they say about statistics.

Is the argument principally flawed?

If you do sell in May, where do you put your money after dumping those stocks? The strategy assumes you know of a better place - an alternative to equities offering greater yield and less risk.

Larry Swedroe, director of research for Buckingham Asset Management, recently told CBS Money Watch that the "sell in May" approach amounted to "pure randomness". He made his claim by running numbers in calendar years from 1950-2007 with the hypothesis of reinvesting money pulled out of equities into 30-year Treasuries during the assumed 6-month market lull. According to his research, the "buy and hold" crowd would have outperformed the "sell in May" crowd in the time frames 1950-2007, 1980-2007 and 1990-2007, with the "sell in May" adherents triumphing in the time frames of 1960-2007, 1970-2007 and 2000-2007.[3,4]

The case for staying in the market

Even if the performance numbers mentioned in the fourth, fifth and sixth paragraphs of this article were absolutely predictable annually, what would the compelling argument be for ditching stocks? Gains would still occur in spring and summer; they would just be lesser gains.

Let's go from hypothesis to reality, specifically what is occurring right now. An investor wanting a divorce from risk for the next six months could decide to bail from stocks and put the assets into short-term Treasuries and money market accounts. Would it be worth it? Maybe not. According to Bankrate.com, 6-month Treasuries were yielding 0.14% as of April 27 and money market accounts were yielding 0.46%. Throw in brokerage charges and taxes you might incur from selling, and getting in and out of equities may look less attractive.[1]

Once you're out, when do you get back in? What if mid-October brings a rally? Do you jump in and buy? What if the bears show up at the start of November? How long do you wait for what might be the market low? Moreover ... who's to say that U.S. economic indicators (or even global ones) might be better than expected this summer? What if the EU arranges a manageable fix for Spain's debt dilemma? What if the real estate market shows signs of heating up in the coming quarters? What if the Fed opts for more easing?

If the "sell in May" strategy sounds more like market timing to you than anything else, it does have some history supporting it - history worth considering. The fact remains, however, that history is no barometer of future stock market performance.

This year's elucidation

As the above observations suggest, a wholesale exit from the market which ignores present and future potentially favorable economic fundamentals can result in a flawed and underperforming strategy. Moreover, reentering the market in a timely and efficacious manner presents its own set of allocation tribulations.

These considerations resulted in a decision by me to recently eliminate underperforming sector ETFs; namely energy, and emerging markets, and reallocate those proceeds to more consumer friendly and technological oriented issues (See: www.analyticsllc.net performance tab). It is my belief that the following four solidifying economic conditions will lead to a sustainable and improved U.S. economic recovery and second half rally: namely, 1) a calming of the intensity of current eurozone fears, which will give impetus to a reaccelerating emerging market economic recovery; 2) a more visible and improving housing market; 3) upward revisions of the consensus real GDP growth forecasts; and, 4) a compelling 12.3 year-end estimated earnings (PE) multiple.

This material was prepared by MarketingLibrary.Net Inc., but modified by Analytics Investment Advisors, LLC where deemed appropriate.

Citations.

1 - www.forbes.com/sites/investor/2012/04/27/stay-in-stocks-or-sell-in-may/ [4/27/12]

2 - money.cnn.com/data/markets/dow/ [4/27/12]

3 - www.cbsnews.com/8301-32778_162-57423130/why-sell-in-may-doesnt-work-for-investors/ [4/27/12]

4 - montoyaregistry.com/Financial-Market.aspx?financial-market=common-financial-mistakes-and-how-to-avoid-them&category=29 [4/27/12]