PRIVATE CLIENT SOLUTIONS

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Market Commentary

Sell in May … Not Today

Strategy Committee

RAYMOND JAMES®

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We rely daily on simple rules to navigate the world around us. Heuristics are mental shortcuts commonly used to simplify problems and avoid cognitive overload. While spending the time to thoughtfully consider all the possible scenarios may produce a more optimal outcome, a mental shortcut often offers a satisfactory solution. If it's cloudy outside, we bring an umbrella. However, if we had opened the weather app, we would have learned it would be a beautifully sunny day during the hours we planned to be outside.

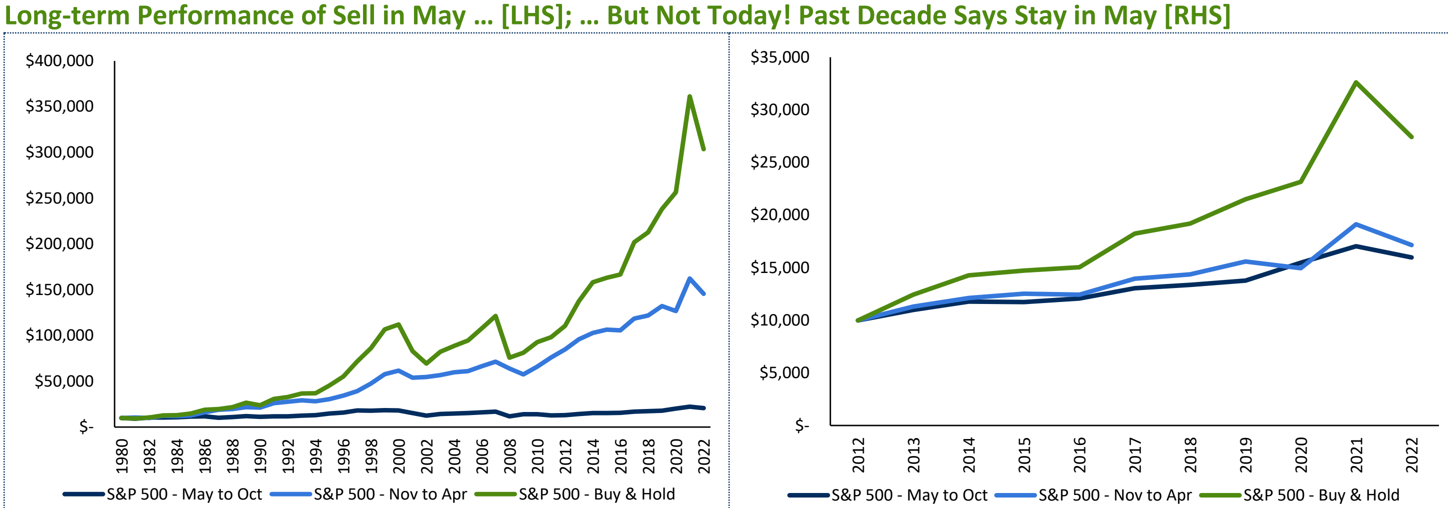
In finance, mental shortcuts are rules of thumb that provide simple solutions to complex problems. "Sell in May and go away" is one such classic example. This theory postulates that investors should exit the market between May and October while staying fully invested from November to April.

The November to April period indeed produces superior returns. Since 1981, 69 per cent of the time, November to April returns have exceeded those of May to October. The average return was 7.0 per cent versus 2.2 per cent, respectively. But for the sell-in-May theory to outperform a buy-and-hold strategy, one must invest the cash proceeds for six months at an annualized yield of approximately 4.5 per cent. In the good old days, when cash offered a competitive return, this strategy may have made sense (more on this later).

As with any rule of thumb, this is worth revisiting occasionally. Over the past decade, the sell-in-May rule has been even more ineffective. The average May to October return has increased to 4.9 per cent (10.1 per cent annualized), thus creating an increased drag on performance for those following the shortcut and exiting the market.

A possible explanation for the improved May to October return profile over the past decade may have been the lack of alternatives to stocks (remember TINA: There Is No Alternative). While bonds and cash offered capital protection over the past decade, they provided little in return. Today, that has changed. It will be interesting to revisit this rule of thumb to see if the May to October return reverts toward its historical average.

Long-term Performance of Sell in May … [LHS]; … But Not Today! Past Decade Says Stay in May [RHS]



Source: FactSet; Raymond James Ltd.; Data as of October 31, 2022. For illustration only. Chart (left): start investing on December 31, 1980 with an initial investment of $10,000. Chart (right): start investing on December 31, 2012 with an initial investment of $10,000.

Time for a Pause

Perhaps the paradigm shift away from "There Is No Alternative" (TINA) will change the future dynamic of sell in May. At least for now, there is good reason to stick around for the next several months.

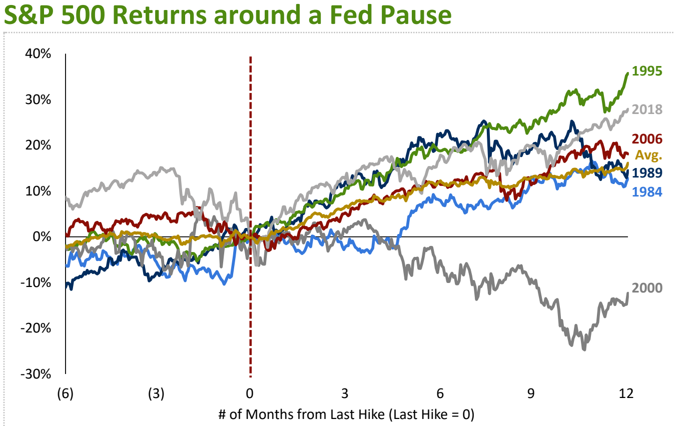
May could very well be the Federal Reserve's (Fed) last rate hike. As we discussed last month, tighter financial conditions are doing much of the Fed's heavy lifting. U.S. Treasury Secretary (and former Fed chair) Janet Yellen reiterated this point, *"Banks are likely to become somewhat more cautious in this environment…we already saw some tightening of lending standards in the banking system prior to that episode, and there may be some more to come."* More restrictive lending conditions *"could be a substitute for further interest rate hikes that the Fed needs to make".*

The point is that we are nearing the end of the hiking cycle, and once the Fed is done, markets tend to produce good returns.

The chart below illustrates S&P 500 returns leading up to, and 12 months after, a Fed pause. Over the last six cycles, the average market return 12 months after the Fed stopped hiking interest rates was 16.1 per cent.

The only exception was in 2000 when the market continued to correct from a period of "irrational exuberance" that drove the dot-com stocks to superficial high valuations.

S&P 500 Returns around a Fed Pause



Source: FactSet; Raymond James Ltd.; Data as of March 31, 2023.

That Ain't No Bull

Investor sentiment, while improved since last year, remains pessimistic, and investor positioning has become defensive. According to the BofA Global Investment Manager Survey, investors overweight bonds and cash at the expense of equities.

Simply put, plenty of new investors can enter the market and support further gains. We just need a reason to support this rotation.

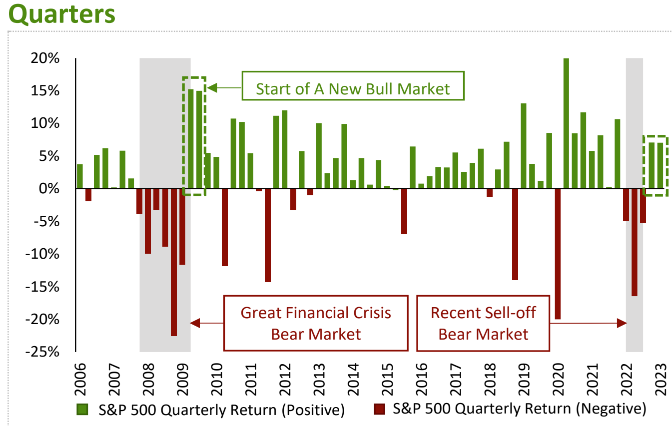
This catalyst could be any of the following: a Fed pause, a better outlook for corporate earnings, easing inflationary pressures and/or economic resiliency that delays the onset of a recession.

Or perhaps it's FOMO (the Fear Of Missing Out). The S&P 500 could very well have entered a new bull market.

As illustrated below, during the last two bear markets (2008/2009 and 2020), the S&P 500 never recorded a positive quarter, let alone two consecutive positive quarters. Only after the market exited the bear territory did we see positive quarterly returns, and similar to 2008/2009, the last quarter marked back-to-back positive gains.

We will only know in hindsight if we've entered a new bull market, but based on some indicators in recent history, the worst may very well be behind us.

Signs of Bull Market: Two Consecutive Positive Quarters



Source: FactSet; Raymond James Ltd., as of March 31, 2023.

Bottom Line

The sell-in-May rule of thumb has become less useful over the past decade, but the mental shortcut will be interesting to revisit in the coming years, as there is now an alternative to stocks. Regardless, a buy-and-hold strategy far exceeds any attempt to time the market.

As for additional reasons to stay in May, the market is predicting a Fed pause in the coming months. Historically, markets have produced solid returns for stocks 12 months after a pause. Given investor sentiment, any positive catalysts may provide additional buying demand for stocks and confirm the nascent bull market.

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