THE Wealth REPORT

Some investors choose to exit the market for several months each year when performance is expected to be flat. What are the merits – and flaws – of this tactic?

SELL IN MAY AND GO AWAY?

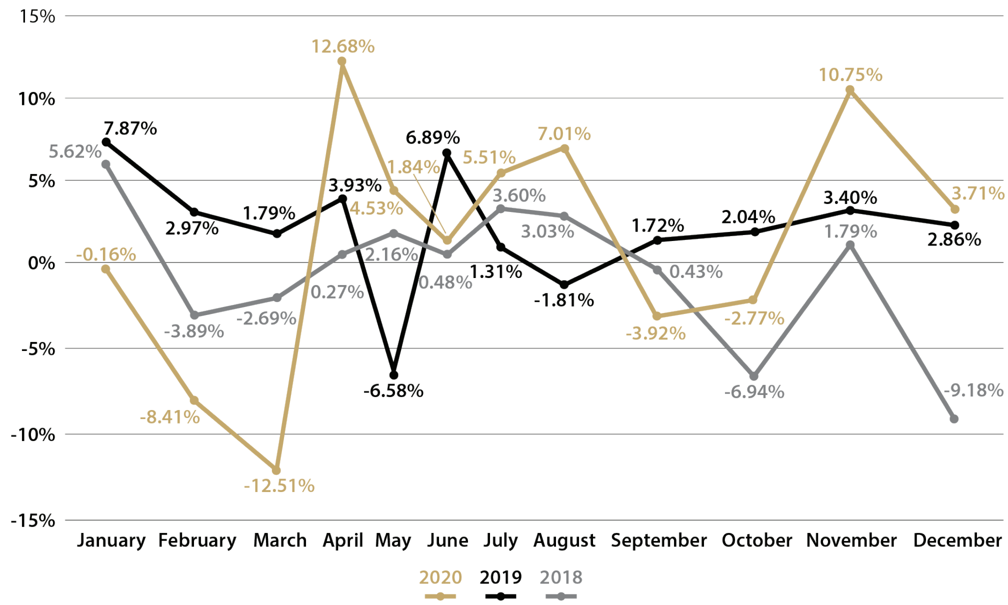
Overview

In the investment world, there is a catchy phrase that gets tossed around this time of year: Sell in May and go away. The tactic is based on the inclination for the stock market to take a bit of a breather during the summer months and either underperform or remain flat.[1]

There is some validity to this approach. The summer months are when people tend to take vacations, so there is less volume trading among individual investors, stockbrokers and institutional managers. And, in fact, there is historical data to support lackluster performance starting in May of each year. For example, from 1950 to 2013, the DJIA averaged a mere 0.3% from May to October, compared to an average gain of 7.5% from November to April.[2] Bear in mind that these are average returns over a 63-year time frame — and averages basically even out the ups and downs that occur from month to month and year over year.

To get an idea of what monthly performance looks like, the accompanying line graph illustrates the S&P 500's monthly returns over the past three years.

Compare S&P 500 Monthly Returns: 2018, 2019 and 2020[3]



When you look at this graph, let your eyes run up and down for each month from May to October. You can see that in just the past three years — which largely represented a bull market — there is a substantial variation in returns during those months, as there are in all months, throughout the year, every year.

"Calendar stock market trends like 'sell in May' do not account for the uniqueness of each period: the economic, business cycle and market environment that differentiates now from the past. Last year is a perfect example, when COVID-19 sent stocks into a tailspin in March and April, followed by a meteoric recovery through the summer and fall."[4]

Seasonal Performance

This is not to say that there are not commonalities in seasonal stock market performance. There are. It's true that summer months yield less trading volume. It's also true that some stocks tend to outperform in cooler weather months from November through April, such as in the consumer discretionary, industrials, materials and technology sectors. According to the Center for Financial Research and Analysis (CFRA), cyclical sectors — on average — tend to outpace defensive sectors during those six months.

However, the opposite is also true. The CFRA reports that defensive sectors (e.g., consumer staples, health care, utilities) tend to outperform the market from May through October.[5]

But should we get lulled into the notion that the market tends to pick up steam in November of each year (a phenomenon known as the "Halloween Effect"), there may be a good reason why those average monthly returns look so good over a long time frame. October is a notorious month for stock market crashes. After all, the Bank Panic of 1907, the Stock Market Crash of 1929 and Black Monday in 1987 all happened during October.

Also note that October precedes the U.S. nationwide Election Day every other year, which is another catalyst of seasonal volatility. It therefore stands to reason that a month that directly follows one that tends to experience volatility will likely post higher returns.

Alternative Investment Strategies

Given that autumn does experience factors that create stock market volatility, it can be a good time to invest when share prices dip. In November, certain sectors, industries and stocks will begin to pick up quickly as the holiday season approaches.

Clearly, there are pros and cons to pursuing a "sell in May and go away" strategy. Investors may want to consider a few other strategies that can be deployed to take advantage of seasonal market performance.

Sector Rotation
Instead of selling to cash in May, an investor might consider selling and reinvesting stocks in more defensive sectors, then rotating back out in autumn.

Active vs. Passive Investment Management
The "go away" tactic implies that an investor adheres to a passive investment strategy. In other words, for part of the year he or she "buys and holds," and for part of the year he or she sells and stays out of the market. An alternative is to engage in active investment management, in which the investor continually monitors his or her portfolio throughout the year and makes changes based on economic factors and stock market trends. This is pretty much the opposite of "going away" because it

requires discipline and due diligence. Many investors choose to engage a wealth manager to manage their portfolio with an active investment strategy rather than try to do it themselves.

Dollar-Cost Averaging

There is, however, a passive way to buy when share prices dip without having to actively monitor the market. Automatic investing takes advantage of dollar-cost averaging (DCA), which is simply investing the same amount of money on a regular basis regardless of market performance. Most people do this through salary deferrals to their employer 401(k) plans. Those contributions buy more shares when prices drop and fewer shares when prices rise. The benefit of DCA is that the cost basis of the total investment generally reduces over time. It also takes the guesswork out of when to invest.[6]

No Harm, No Foul?

Is there any real harm to selling in May and going away? There could be. It depends on how the market performs in the subsequent months, and we all know they are unpredictable. Bear in mind that the “sell in May” strategy is basically a form of market timing. That’s an investment strategy in which an investor attempts to jump in and out of the market based on consumer trends, share prices, market momentum and economic factors such as the direction of interest rates.

Investors, even professional money managers, are not able to navigate these variables with market success over long periods of time, and many financial advisors do not advocate market-timing strategies. Furthermore, it’s important to recognize that stocks tend to improve performance cumulatively over years, so hopping in and out of the market for days or months at a time can stymie this trajectory.

For example, consider the growth of $10,000 invested in the S&P 500 between 2005 and the end of 2020. An investor who remained in the market throughout the entire period would have earned significantly more than one who speciously tapped out during the market’s best days. The accompanying table illustrates how much in earnings the investor lost based on his or her lack of market foresight.[7]

This hypothetical example is used for illustrative purposes only and does not reflect the performance of any specific investment. This example does not take into consideration any investment fees and expenses or the effect of taxes on distributions.

S&P 500: $10,000 Investment Growth from Dec. 31, 2005, to Dec. 31, 2020[8]

Days in the market	Annualized annual return	Ending value
Missed the 30 best days	-1.88%	$7,526
Missed the 20 best days	0.88%	$11,400
Missed the 10 best days	4.31%	$18,829
Fully invested the entire period	**9.88%**	**$41,100**

Missing only the best days over a 15-year period may seem unlikely, but, as a point of reference, refer back to the first line graph to see best performing months in the past three years:

- 2018 – January, July, August
- 2019 – January, April, June
- 2020 – April, August, November

In other words, an investor who sold in May and went away in those three years would have missed some of the strongest returns during the summer months. It is because we can't predict when the "best days" will occur that the "buy and hold" strategy tends to outperform.

Finally, in addition to market performance opportunity, consider the costs associated with "sell in May." These may include trading expenses and taxes on short-term capital gains in a taxable account.

Final Thoughts

As with most investment strategies, there can be advantages to the "sell in May and go away" tactic. What is important is that each investor develops a portfolio management style that appropriately reflects his or her financial goals, risk profile and timeline. Exiting the market a few months at a time may be more fitting for an active investor with a shorter investment horizon.[9]

However, maintaining a diversified portfolio with a customized asset allocation — which may or may not include an active trading component — is a lower-risk and well-tread path for retirement planning. Speak with an experienced financial professional to help determine which investment strategies best suit your circumstances.

[1] Troy Segal. Investopedia. April 24, 2021. "Sell in May and Go Away Definition." https://www.investopedia.com/terms/s/sell-in-may-and-go-away.asp. Accessed April 26, 2021.
[2] Ibid.
[3] YCharts. "S&P 500 Monthly Return." https://ycharts.com/indicators/sp_500_monthly_return. Accessed April 26, 2021.
[4] Fidelity. April 23, 2021. "Should you 'sell in May'?" https://www.fidelity.com/viewpoints/active-investor/sell-in-may. Accessed April 26, 2021.
[5] Ibid.
[6] James Chen. Investopedia. Jan. 24, 2021. "Dollar-Cost Averaging (DCA)." https://www.investopedia.com/terms/d/dollarcostaveraging.asp. Accessed April 26, 2021.
[7] Putnam Investments. February 2021. "Time, not timing, is the best way to capitalize on stock market gains." https://www.putnam.com/literature/pdf/II508-ec7166a52bb89b4621f3d2525199b64b.pdf. Accessed April 26, 2021.
[8] Ibid.
[9] Fidelity. April 23, 2021. "Should you 'sell in May'?" https://www.fidelity.com/viewpoints/active-investor/sell-in-may. Accessed April 26, 2021.