Should Investors Sell in May?

SYNOPSIS

- The story of large money managers selling equities in May and then returning in November pops up right around this time every year.
- History shows that this strategy may have worked in the past, but what matters more is if it will work going forward.
- Easy money left the stock market a long time ago, and it's never coming back.

SELL IN MAY?

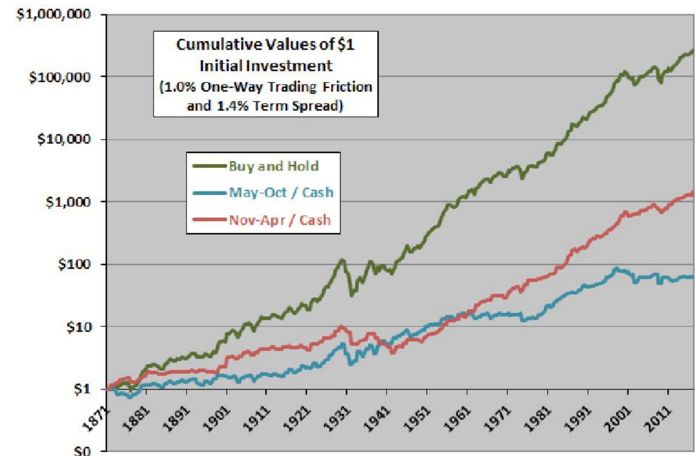
There is a saying in equities, "Sell in May and go away," which refers to the theory that large money managers sell equities in May and then return in November. The commotion gets even louder on Wall Street when the stock market starts off strong and continues to gain momentum into the spring, as it has this year.

The story goes that large money managers like to lock in gains before the summer months for two interrelated reasons:

1. **Vacation**: Fund managers don't want to have to worry about being fully invested while on vacation. They want to relax and enjoy their time away from the market.
2. **Increased Volatility**: Summer months typically see low trading volumes given that traders and investors are also on vacation. Less activity mean less liquidity which results in more volatility.

Behaviors and emotions do impact market returns in the short-term, so it's worth observing historical data to see if they support selling in May. The following chart depicts simulated results for three different strategies from April 1871 through April 2017.

Selling in May and buying back in November (red line) would have taken a $1 investment and turned it into $1,410. The opposite, selling in November and buying back in May, did much worse (blue line) by only returning $62 over the same period. Therefore, it appears that the adage holds some merit.



Source: https://www.cxoadvisory.com/3873/calendar-effects/sell-in-may-over-the-long-run/

Admittedly, there are several ways to test the efficacy of selling in May, and the assumptions used in backtesting can often lead to different results. Play with data enough and it's very likely that a different outcome could surface.

> *Behaviors and emotions do impact market returns in the short-term…*

However, the green line shows the performance of a simple buy and hold strategy and immediately puts things into perspective. The return on a $1 investment grows to well over $300,000 during the same period, which is over 200-times larger than the red line.

Any trading strategy must be able to outperform a buy and hold by a considerable margin to justify the trading costs and taxes paid over time. I find it highly unlikely

Global Financial Private Capital, is an SEC registered investment adviser principally located in Sarasota, Florida. Investment Advisory Services offered on a fee basis through Global Financial Private Capital, LLC. Securities offered through GF Investment Services, LLC, Member FINRA/SIPC. SEC registration does not imply a level of skill or training.

that massaging data and modifying assumptions could close the gap between the green and red lines.

Simply put, even if there is some merit to stocks doing better when it's colder outside versus hot and humid, doing nothing at all appears to be far superior.

IMPLICATIONS FOR INVESTORS

Think about what it took to fix a car back in the 1970s versus today. Back then, a wrench and a basic understanding of an engine could alleviate most issues. Today, consumers practically need an engineering degree to change the air in the tires. The sophistication has turned cars into computers on wheels, and trained mechanics are now the only ones suited to repair them.

Financial markets have evolved in a similar manner. Consider the following:

- **Depth of Information**: Satellites now capture high-resolution pictures of parking lots, shipyards, farmland, etc. Computers then analyze these images to count the number of cars in each parking lot, ships in port, and corn stalks being harvested to look for trends in economic data. Traders then use this data to inform their buy/sell decisions.
- **The Need for Speed**: Speed is so critical that it motivated a company (Spread Networks) to spend over $300 million to lay 825 miles of straight-line optical fiber to shave off three microseconds (three millionths of a second) of communication time between the futures markets in Chicago to the stock markets in New York. Access to this fiber line runs $10 million a year, and business is booming.
- **Mind Reading**: Firms now utilize Natural Language Processing (NLP) in their trading strategies and are completing tasks no human could ever tackle. NLP is a technology that trains computers to analyze and derive meaning from human language in a smart and useful way. It is based on artificial intelligence that examines patterns in data to improve a program's own understanding.

Back when we could fix our own cars, only the military used satellites, the world wide web was science fiction, and computer programmers had not even coded Pac-Man yet let alone begun trying to teach machines how to predict human thought.

Those who work on Wall Street have also changed. Old school traders have been replaced with MBAs and PhDs from some of the most prestigious academic institutions in the country, and these traders don't use wrenches.

Said another way, today's stock market consists of artificial intelligence running on top of wires that transfer data close to the speed of light being driven by some of the smartest people alive. There is simply no conceivable way that a trading strategy as basic as sell before Memorial Day and buy back after Halloween could work on a consistent basis.

The bottom line is that easy money left the stock market a long time ago, and it's never coming back. Keep to a long-term investment strategy because trying to capture anything in the short-term on a consistent basis is going to require a lot more than an old saying that rhymes.

Sincerely,

Mike Sorrentino, CFA
Chief Strategist,
Global Financial Private Capital
mikeonmarkets.com

This commentary is not intended as investment advice or an investment recommendation. It is solely the opinion of our investment managers at the time of writing. Nothing in the commentary should be construed as a solicitation to buy or sell securities. Past performance is no indication of future performance. Liquid securities, such as those held within DIAS portfolios, can fall in value.

Global Financial Private Capital, is an SEC registered investment adviser principally located in Sarasota, Florida. Investment Advisory Services offered on a fee basis through Global Financial Private Capital, LLC. Securities offered through GF Investment Services, LLC, Member FINRA/SIPC. SEC registration does not imply a level of skill or training.