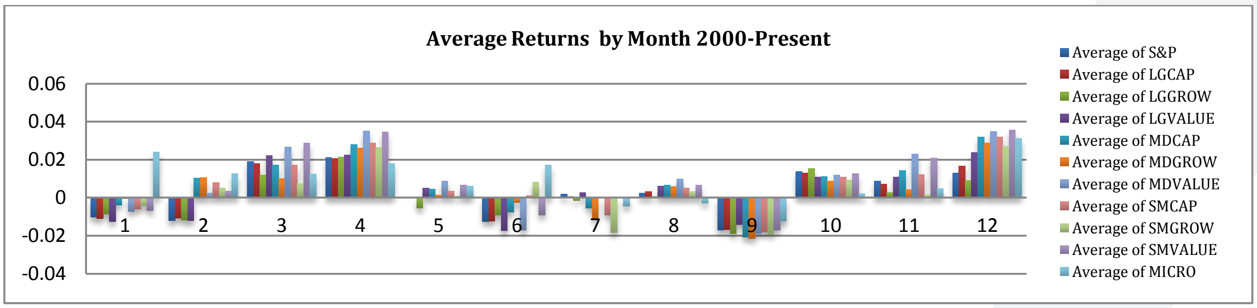
September 18, 2012

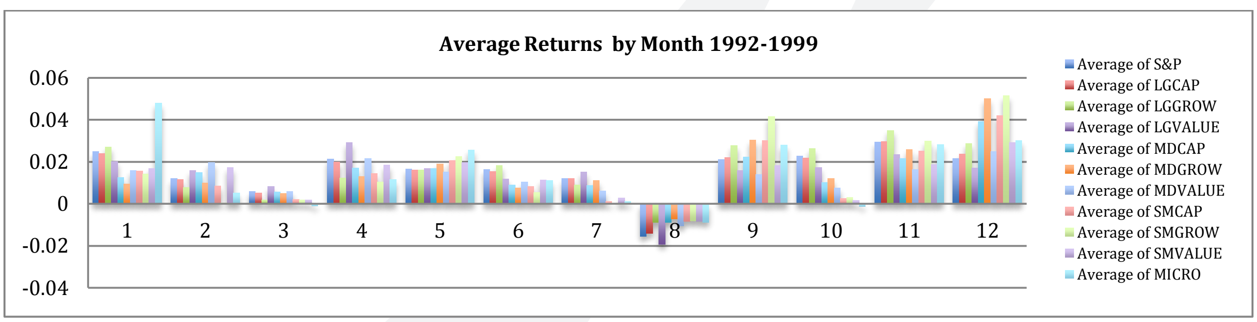
Sell in May and Go Away?

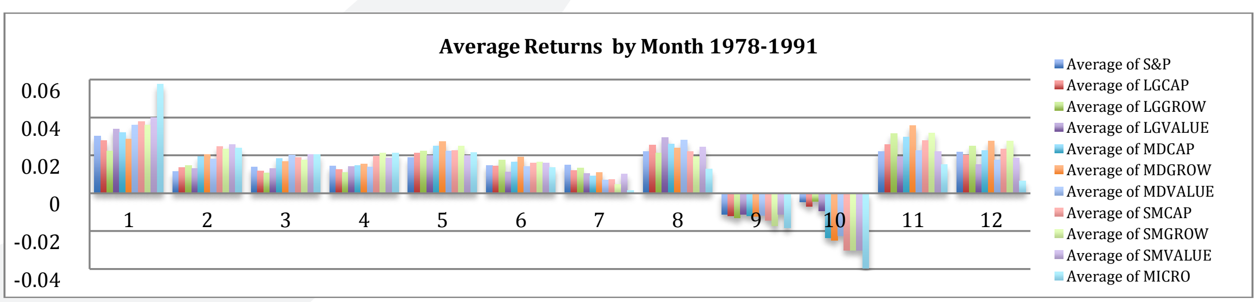
"Sell in May and go away" is an old British adage popular in the 70s that has become popular again. The actual strategy advises going to cash in May and buying back into the market in October. Proponents of this strategy argue that stock prices so languish in this six-month period that investors are better off avoiding it altogether. The idea of shutting down your portfolio and just heading to the beach sounds appealing, but is it profitable?

The reason this strategy has regained popularity is how exceptionally well it would have performed of late. Since 2000 the S&P 500 has dropped an average 0.2% monthly from May to October, compared to a monthly gain of 0.7% in the rest of the year. In 2010 and 2011 an average month in November to April outperforms an average month in May to October by 2.8% and 2.5%, respectively. Evidence seems compelling for this adage.



Too bad this strategy sacrifices so much return in the longer term. The following charts show average size/style returns by month in two earlier periods. For 1978-1991 and 1992-1999, November to April provided 1.9% for both periods while May to October provided an average monthly return of 0.9% and 1.2%, respectively. Though May to October returns were not as strong - there's no justification to walk away from the stock market during the summer months. If an investor put in $1,000 at the beginning of 1990 and persistently carried out the "Sell in May..." strategy for the following twenty two years, he would end up with $4,736 if invested in the S&P 500 while a 'buy and hold' investor would have amassed $6,458.





The above numbers illustrate the degree to which data can fit a bias, at least for a time. That being said, there are a couple very interesting seasonal patterns to note from these charts. The famous ‘January Effect’ wasn’t present in the latest period, though MicroCaps bucked that trend and shined during all three periods. Also, the final two months of the year significantly outperformed the rest of the year during all three intervals. In fact, average monthly return for November and December is more than double that for other months since 1978.

Average Monthly Return				
	1978-present	1978-1991	1992-1999	2000-present
Jan-Oct	0.8%	1.2%	1.4%	0.1%
Nov-Dec	1.9%	2.2%	2.5%	1.1%

Market timing is a tricky business that doesn’t pay off over time, but hopefully we can look forward to a strong finish to an already pretty good 2012.

Alex