Sell in May and Go Away?

The "sell in May" maxim has been around for years. But is it valid? And does it work for the average investor?

Historical evidence shows that stocks do tend to underperform in the summer months. But not always.

With the current bull market now in its eleventh year and stocks at all-time highs, many investors may be tempted to "sell in May and go away." This old investment adage suggests that investors might avoid a potential seasonal decline in stock prices by selling in May and reinvesting in November. But the success of such a strategy in a given year is questionable, and the reality of employing it involves other considerations.

What History Shows

At first glance, historical stock index performance seems to validate a "sell in May" approach. A groundbreaking study in 2002 showed that global stock market returns were higher during the winter (November to April) than during the summer (May-October) in 36 out of the 37 countries in the study.[1] A more recent study showed that returns averaged 4% higher during the November-April period than during May through October.[2]

There are several potential reasons for this seasonal variation.

- **Capital inflow.** Cash inflows are usually much greater during the November-April stretch, particularly during the beginning of each calendar year. This is the period when most bonuses and tax refunds are paid, and invested, and when pension plans typically make large contributions. In addition, IRA contributions are due by April 15 each year.
- **Vacations.** As one pundit once remarked, "During the summer, investors focus more on their tans than their portfolios." This typically reduces trading volume during the summer months.
- **Earnings.** End-of-year earnings revisions may contribute to the market's historic underperformance in the third quarter. Investors may be forgiving of soft Q1 and Q2 earnings as they look ahead to solid full-year estimates. Yet if Q3 performance estimates are also under par, investors may be more likely to sell to cut losses. This could help explain why September has historically been the worst performing month of the year.
- **Mutual fund sell-offs.** Mutual funds publish their holdings quarterly. As a result, they may engage in end-of-quarter "window dressing," meaning that they sell their underperformers so as not to appear to be holding losing stocks. And since many funds have fiscal years ending in October, they may engage in an even more thorough portfolio pruning in the final quarter of their calendar year, possibly adding to this overall seasonal pressure.

But the pattern is not necessarily consistent from year to year. Consider 2017, when the S&P 500 gained 8.0% from May through October compared with the 2.8% rise from November through the following April, 2018. And last year, the index showed relatively steady rise from March through late September, then fell almost 20% by Christmas. The takeaway here is that many factors drive stock prices. Seasonal variation is only one of them.

Other Considerations

Any investors contemplating a "sell in May" strategy will also want to take into consideration trading costs, taxes, and where they plan to 'park' their money between May and November. Trading costs vary, but can strip up to 1% or more off profits. Taxes on short-term gains (on investments held one year or less) are at ordinary rates, which are typically higher than rates on long-term capital gains. What's more, even if summertime returns are low for stocks, they may still be higher relative to money markets and similar investment substitutes. There are also obvious risks -- most notably, that you may miss out on a summer rally, or that you might postpone getting back in the market and languish in low-yielding cash equivalents.

Think Buy and Hold Instead

In the end, a sell-in-May strategy is just another way to try to time the market. And as study after study has shown, trying to time markets is a losing game. Even the experts cannot manage to succeed over time. Instead of trying to time the market, you may be better off with a well-coordinated buy-and-hold investment strategy that is based on your personal risk tolerance and time frame. While past performance is no guarantee of future results, the stock market has always recovered from every downturn. Keep in mind that rebounds can sometimes occur quite rapidly.

[1]Source: American Economic Review, *The Halloween Indicator, 'Sell in May and Go Away': Another Puzzle*, Bouman and Jacobsen, December 2002, revised October 2009.

[2]Source: *The Halloween Indicator, "Sell in May and Go Away": Everywhere and All the Time*, Cherry Y. Zhang and Ben Jacobsen, October 2018.