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MANCHESTER
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Insight

Come Back on St. Leger's Day?

-Manchester Capital Management Strategy Group

As the calendar turns to May, investors are often bombarded with the question of whether to "Sell in May and go away," meaning to exit the stock market at the end of April and return after October. Previous years have shown that most of the market's gains occur in the six-month period between November and April, prompting the advice to sit out the summer.

The Decisive Heat for the Great St. Leger Stakes at Doncaster, 1839, John Frederick Herring.
The St. Leger Stakes was founded in 1776. It is the oldest and final race in the British Triple Crown.

The original expression was "Sell in May and go away, come back on St. Leger's Day." The phrase originated in England, probably around the late 18th or early 19th century. St. Leger's Day refers to the St. Leger's Stakes, the third and final horse race in the British Triple Crown, which occurs on a Saturday in mid-September. After the race, stock brokers typically returned to work after a quiet summer, having closed their positions early in the season to enjoy summer events such as Ascot, Wimbledon, and the Henley Regatta.

Does the strategy actually work? According to Stock Trader's Almanac data, in the 66 years between 1950 and 2015 the Dow Jones Industrial Average gained 0.4% between May and October and 7.4% from November through April. A firm called Equity Clock has done extensive research into seasonality[3]. They point out that the phrase originally applied to the base metal markets, as smelters in Europe shut down in July and August for Europe's extended holiday season. As a result, demand for base metal concentrates slowed in May and recovered in September. While base metals do still show this seasonal pattern (though muted over the years), the phrase was transformed to apply to equity markets.

In studying the same 66 years of data, Equity Clock has found that to maximize returns one should sell on May 5th and buy on October 28th. Your average gain for this period would be 8.4% and it would be profitable 81% of the time. If you were to ride out the summer by buying on May 5th and selling on October 27th, your average gain would be 0.14% and you would make money 62% of the time. Numerous other studies have found the same thing: that the stock market produced the majority of its gains between Halloween and May Day.

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An interesting new study by Kam Fong Chan and Terry Marsh[2], written last month, suggests that "Sell in May" works, but the effect is concentrated in the third year of the election cycle and is statistically non-significant in the other three years. Since this is the first year of the cycle, this argues for standing pat. We can't live on averages, we have to decide what to do today.

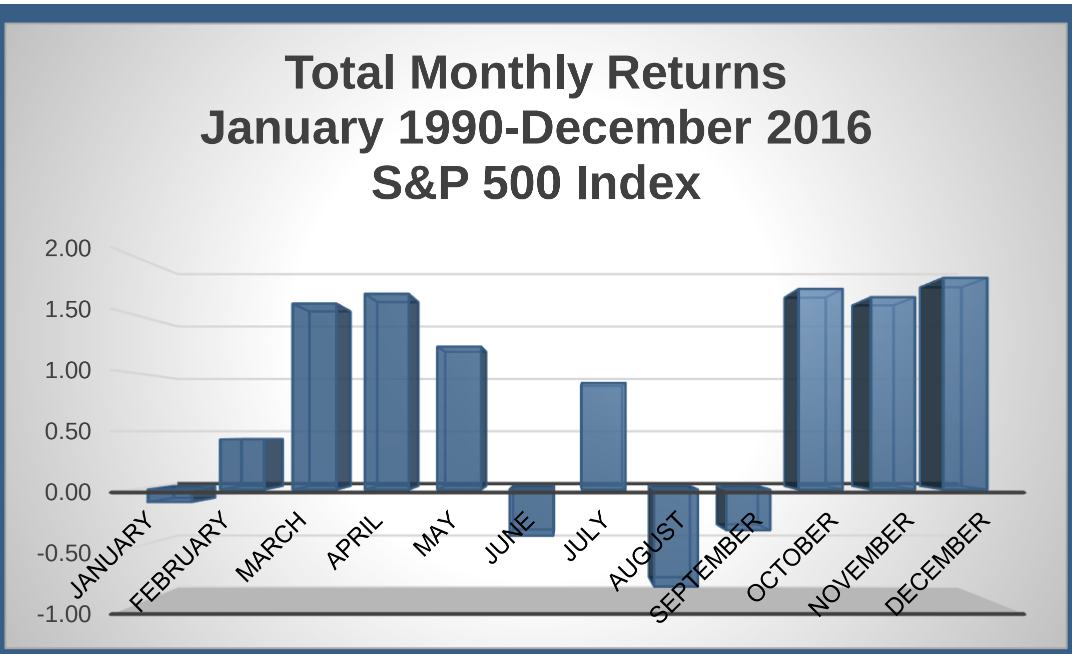
We defer to the fundamental picture. True bear markets are associated with recessions and while they can always strike unexpectedly, recessionary risk is not high for the next six months. Valuations may seem rich, but are not ridiculous given low interest rates. Monetary policy remains supportive and the global tide of populism appears to be receding.

After initial exuberance, our expectations for a pro-growth political agenda have been tempered with the markets no worse for the wear, thanks to a string of very strong first quarter earnings reports and outlooks. That said, nominal economic growth is slowing a bit at the margin. Central bank tightening could potentially be disruptive and may simply serve to **flatten the bond yield curve** and signal an impending recession. Geopolitical risks abound and a busy Washington political agenda could disrupt business and consumer confidence. The S&P 500 remains strong but the "average" stock is lagging the performance of the largest stocks in the index.

a phenomenon where bonds maturing in 2 years or less offer the same yield as bonds maturing in 10 years or more

We hope that everyone has an enjoyable summer. We remain vigilant and will look to St. Leger's Day to assess this phenomenon's record in 2017.

The data in the chart on the right shows the average returns for each calendar month going back 26 years. It is clear, even from this small sample size, that there is a pattern of worse average returns during months between May and September.



Data sourced from Morningstar

ENDNOTES

1. 1 - http://www.equityclock.com/seasonality/
2. 2 - Chan, Kam Fong and Marsh, Terry, Buy Equities in Winter and Sell in May in Pre-Election Years: Market Premiums and Political Uncertainty in the Presidential Cycle (April 26, 2017). Available at SSRN: https://ssrn.com/abstract=2903067 or http://dx.doi.org/10.2139/ssrn.2903067