LPL RESEARCH

WEEKLY MARKET COMMENTARY

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SELL IN MAY?

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KEY TAKEAWAYS

The May through October period has historically been the weakest six months for equities.

However, in recent years the six-month stretch has seen higher equity prices.

This year, with stocks up significantly from the December lows, we advise more caution than previous years.

SELL IN MAY AND GO AWAY

"Sell in May and go away" began in England originally as "sell in May and go away until St. Leger's Day." The saying was based around the St. Leger Stakes, a popular horse race in September that marked the end of summer and a return of the big traders and market volume.

"Sell in May and go away" is probably the most widely cited stock market cliché in history. Every year a barrage of Wall Street commentaries, media stories, and investor questions flood in about the popular stock market adage. This week, we tackle this commonly cited seasonal pattern, and why some seasonal weakness could make sense in 2019.

THE WORST SIX MONTHS OF THE YEAR

"Sell in May and go away" is the seasonal stock market pattern in which the six months from May through October are historically weak for stocks, with many investors believing that it's better to avoid the market altogether by selling in May and moving to cash during the summer months.

As Figure 1 shows, since 1950 the S&P 500 Index has gained 1.5% on average during these six months, compared with 7% during the November to April period. In fact,

1 THE NEXT SIX MONTHS HAVE BEEN THE WORST ON AVERAGE

6-Month Returns For S&P 500 Index (1950–2018)

6-Month Period	Average Return %	% Higher
Nov–Apr	7.0%	76.8%
Oct–Mar	6.5	69.6
Dec–May	5.6	72.5
Sep–Feb	4.7	68.1
Aug–Jan	4.5	69.6
Jul–Dec	4.4	69.6
Jan–Jun	4.1	68.1
Feb–Jul	4.0	71.0
Mar–Aug	4.0	71.0
June–Nov	2.9	66.7
Apr–Sep	2.5	63.8
May–Oct	1.5	63.9

Source: LPL Research, FactSet 04/26/19

Performance shown is price returns ex dividends.

All Indexes are unmanaged and cannot be invested into directly. Past performance is no guarantee of future results.

The modern design of the S&P 500 stock index was first launched in 1957. Performance back to 1950 incorporates the performance of predecessor index, the S&P 90.

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out of all six-month combinations, the May through October period has produced the worst average return.

Taking things a step further, we found that stocks pull back from peak to trough an average of 11.1% during these worst six months. With the S&P 500 up 25% from the December lows, we do think the potential for a correction of that magnitude is possible.

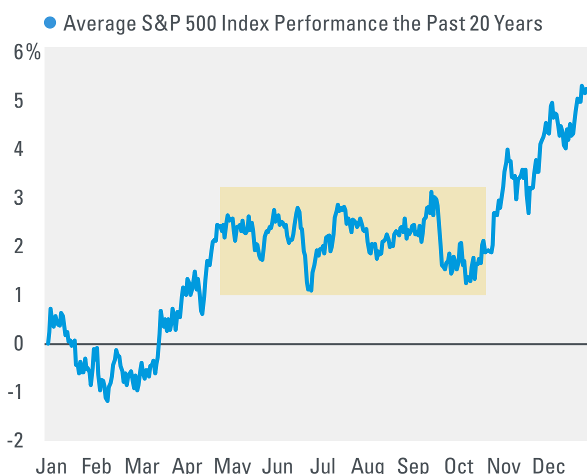
WHAT HAVE YOU DONE FOR ME LATELY?

As we head into this seasonally weak period, keep a few things in mind. First, the S&P 500 has closed higher during the month of May six consecutive years—so "Sell in June" might be more appropriate. Not to mention these "worst six months" have been higher six of the past seven years. The point is that investors shouldn't necessarily blindly sell May 1, but rather be aware that volatility tends to happen in the summer and fall months. For instance, last year the S&P 500 closed higher in May, June, July, August, and September, and then lost 7% in October for the worst monthly drop in nearly seven years.

Also consider the four-year presidential cycle. The previous two pre-election years saw substantial pullbacks during these worst six months. In 2011, the S&P 500 lost nearly 20% after the U.S. debt downgrade in August of that year. Then in August 2015, the Dow Jones Industrial Average had its first ever 1,000-point drop on Chinese currency and economic concerns. Considering the S&P 500 is near all-time highs and up more than 25% from the December lows, more volatility could be forthcoming.

Figure 2 shows what the S&P 500 has done on average the past 20 years. It is quite clear that the majority of the gains have tended to happen early and late in the year. It is the middle part of the year when things have tended to get quite choppy.

2 THE NEXT 6 MONTHS COULD BE CHOPPY



Source: LPL Research, FactSet 04/30/19

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WHAT DOES A BIG START TO THE YEAR MEAN?

As we noted last week, new highs have tended to resolve with above-average returns in the longer term, but a pullback near term is possible. And we have to mention the list of near-term potential worries that could produce some skittishness: a disagreement with China over trade as the finish line for a deal nears (this risk surfaced over the weekend), possible U.S. tariffs on European autos, Brexit and other structural challenges in Europe, pre-prescribed defense spending cuts, the federal debt ceiling, and a possible late-year rate hike from the Federal Reserve.

Sometimes though, it could be as simple as a big start to a year makes stocks more susceptible to a pullback. As Figure 3 shows, the previous five times the S&P 500 was up more than 14% during the first four months of a year, we saw below-average returns during the usually weak May to October period. In fact, only once did stocks rise during those six months, with substantial peak-to-trough pullbacks occurring three times. With the S&P 500 up 17.5% this year as May began, history has shown that substantial gains over the next six months might be tough to come by.

CONCLUSION

We're entering the historically worst six months of the year for stocks, but that doesn't mean investors should simply sell and buy back in after Halloween.

3 BIG STARTS TO A YEAR CAN PRODUCE WEAK RESULTS GOING FORWARD

S&P 500 Index Performance During the Worst Six Months of the Year

Year	Return First 4 Months >14%	May–Oct Return	Max Pullback
1967	17.0%	-0.1%	-6.5%
1975	27.3%	2.0%	-14.1%
1983	16.9%	-0.5%	-6.9%
1987	19.1%	-12.7%	-33.2%
1998	14.6%	-1.2%	-19.3%
2019	17.5%	?	?
Average		-2.5%	-16.0%
Median		-0.5%	-14.1%
Count		5	
Higher		1	

Source: LPL Research, FactSet 5/3/2019
Date: 1950–05/03/19

Performance shown is price returns ex dividends. All indexes are unmanaged and cannot be invested into directly. Past performance is no guarantee of future results. Performance back to 1950 incorporates the performance of predecessor index, the S&P 90.

Potential catalysts for a sell-off are growing, and various events have sparked large corrections in recent years. It is important to note, however, that a correction is just that—a correction. We continue to think the fundamentals support continued economic growth. Case in point: On May 2, first quarter productivity rose at the fastest year-over-year pace since 2010. Higher productivity helps to offset rising labor costs, which can help mitigate inflationary pressures and support healthy profit margins for U.S. companies—thus extending this nearly 10-year-old economic cycle.

We believe there are enough potential positive catalysts to possibly push the S&P 500 through our year-end fair value target of 3,000 this year. But it won't be a straight line. We recommend a market weight equities allocation, as a seasonal correction is quite likely over the coming months. We would be buyers on any material weakness, as long as the fundamentals remain consistent with continued economic expansion. ■

IMPORTANT DISCLOSURES

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. All performance referenced is historical and is no guarantee of future results.

The economic forecasts set forth in this material may not develop as predicted.

Investing involves risks including possible loss of principal. No investment strategy or risk management technique can guarantee return or eliminate risk in all market environments.

All indexes are unmanaged and cannot be invested into directly. Unmanaged index returns do not reflect fees, expenses, or sales charges. Index performance is not indicative of the performance of any investment.

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DEFINITIONS

Gross domestic product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis. It includes all of private and public consumption, government outlays, investments, and exports less imports that occur within a defined territory.

Earnings per share (EPS) is the portion of a company's profit allocated to each outstanding share of common stock. EPS serves as an indicator of a company's profitability. Earnings per share is generally considered to be the single most important variable in determining a share's price. It is also a major component used to calculate the price-to-earnings valuation ratio.

INDEX DESCRIPTIONS

The Standard & Poor's 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. The modern design of the S&P 500 stock index was first launched in 1957. Performance back to 1950 incorporates the performance of predecessor index, the S&P 90.

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